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NAVAL POSTGRADUATE SCHOOL

Monterey, California



THESIS

CONTRACT AUDIT FOLLOWUP:
ITS IMPACT ON DEFENSE CONTRACTING

by

David Van Smith

December 1983

Thesis Advisors:

William J. Haga
Ronald A. Weitzman

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The primary purpose of this study was to objectively investigate the specific claims of critics and to explore the overall impact of the followup policy on defense procurement. The thesis is based on an analysis of data collected from interviews of procurement managers, contracting officers, and auditors within the state of California and telephone discussions with procurement professionals nationwide.

The results of the research indicate that the contract audit followup policy: (1) adversely affects the independent role of the contracting officer; (2) attracts unnecessary attention to the contracting officer/auditor relationship; (3) imposes uneconomical goals on defense procurement; and (4) fails to improve effective use of the government's audit resources.

The results provide useful insight into the feelings and opinions of contracting practitioners and should assist decision makers in testing their opinions and theories about the effects of the policy on defense procurement.

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**Contract Audit Followup:
Its Impact on Defense Contracting**

by

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Lieutenant, United States Navy
B.S., University of North Carolina at Greensboro, 1975

Submitted in partial fulfillment of the
requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT

from the

NAVAL POSTGRADUATE SCHOOL
December 1983

ABSTRACT

Department of Defense Directive 7640.2 (previously 5000.42), "Policy for the Followup of Contract Audit Reports," has created controversy both within DoD and the defense industry. Critics have claimed that the policy causes a fundamental shift in the relationship between the contracting officer and contract auditor, strengthening the auditor's role while eroding the independence and authority of the contracting officer. The available literature on the policy is highly subjective and consists primarily of the assertions of top management, both in government and industry, either supporting or denouncing the policy.

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I. INTRODUCTION

A. A CONTRACT AUDIT FOLLOWUP POLICY FOR DOD

In 1978 the General Accounting Office (GAO) reported that fraud in the Federal Government amounted to \$12 to \$15 billion annually [Ref. 1:845-A24]. In February, 1981, the Congressional testimony of the Comptroller General recounted the details of a January, 1981, GAO report that conservatively estimated \$25 billion in federal audit findings that remained unresolved.¹ The report showed that nearly half of those audit reports were issued by the Defense Contract Audit Agency (DCAA), which audits defense contractors [Ref. 1:872-A2].

Under growing pressure to restore an image of integrity and sound management to the procurement process, in August of 1981, DoD officials issued the department's first formalized policy for the followup of contract audit reports: DoD Directive (DoDD) 5000.42.² In December, 1982, the policy was revised and reissued as DoDD 7640.2.³

The new contract audit followup policy caused an immediate uproar, both within the department and within the defense industry. The sharpest criticism came from defense contractors who claimed that there would be a fundamental shift in the relationship between the contracting officer and the contract auditor. Many perceived that the change would strengthen the auditor's influence in the contracting process beyond the traditional role of financial adviser.

¹A similar report in 1978 revealed approximately \$4.3 billion in unresolved audit findings.

²DoD Directive 5000.42 appears in Appendix C.

³DoD Directive 7640.2 appears in Appendix B.

Many viewed DoDD 5000.42 as eroding the independence of the contracting officer in coordinating the professional counsel of a team of advisers by over-emphasizing the advice of the auditor. Their claim was that the contracting officer's flexibility in negotiating contractual pricing arrangements would be restricted, prolonging the negotiation process and perhaps increasing the number of contractors' appeals to the courts and the Armed Services Board of Contract Appeals (ASBCA).

DoDD 5000.42 also received criticism from within DoD, particularly among procurement managers and contracting officers. The directive established a system for the followup of contract audit reports requiring the intensive oversight of management and comprehensive reporting to top government officials. There were concerns regarding the increasing commitment of resources to audit activities; an indication that top government officials were perhaps becoming less confident in DoD's ability to judiciously manage its procurement system. Many procurement managers were also troubled by the increased burden on administrative resources imposed by the followup and reporting procedures. That concern led one senior contracting manager to describe the followup policy as "a Frankenstein monster out of control!"

Although many procurement managers and contracting officers have privately expressed their opinions of the contract audit followup policy, there is an understandable reluctance to openly criticize official DoD policies. Therefore, the purpose of this study was to explore the impact of the followup policy from the practitioner's viewpoint; to investigate the claims of critics, and report the results.

B. BACKGROUND

Every department and agency in the Federal Government has established procedures to ensure that public resources are responsibly managed. However, with the advent of the widely publicized "fight against fraud, waste, and abuse" in public programs and operations, government officials have stepped up their efforts in recent years.

In response to a Presidential memorandum, the Office of Management and Budget (OMB), in March, 1978, issued Circular A-73, "Audit of Federal Operations and Programs." Reports on unresolved audit findings to Congress by the General Accounting Office (GAO) created a lot of legislative activity linked to the problem of unresolved audit findings. Congress passed the Inspector General Act of 1978 which established the office of Inspector General in thirteen federal agencies and departments. In 1981, Congress enacted Public Law (PL) 96-304, which required: (1) the disposition of all outstanding audit reports by 30 September 1981; and (2) the resolution of all new audit reports within six months of issuance. Congress also considered other measures directly aimed at tightening the accountability of public managers:

1. The Federal Manager's Accountability Act of 1981.
2. The Financial Integrity Act of 1981.
3. The Debt Collection Act of 1981 [Ref. 1:872-A5].

In March of 1981, the President's Council on Integrity and Efficiency was established. The council consisted of all Inspectors General, and included other top officials of the Department of Justice and the Federal Bureau of Investigation. Those individuals were held personally responsible for the followup of audit reports on federal activities. DoD created a similar council to monitor the followup of its audit reports.

It was in this environment of intensified management attention to audit activities that DoD issued its first policy for following up on contract audit reports: DoDD 5000.42. In September, 1982, OMB issued Circular A-50, "Audit Followup." The Department of Defense incorporated that new guidance into its contract audit followup policy by issuing a revised directive, DoDD 7640.2 in December, 1982.

C. ASSUMPTIONS

The research report that follows assumes that the reader is familiar with the the basic activities involved in DoD procurement and the fundamental relationships which exist among procurement managers, contracting officers, and contract auditors. To assist the reader, Appendix A contains key definitions related to contract audit followup and an explanation of the acronyms used in this report.

II. METHODOLOGY

A. CONDUCT OF THE STUDY

Since DoD's official policy for contract audit followup began with DoDD 5000.42 in August 1981, there is a limited amount of literature on the subject. That which is available is highly subjective and consists primarily of the assertions of top management, both in government and industry, either supporting or denouncing the policy.

Defense contractors, speaking through industry associations, have been clamoring for an independent survey of practitioners to determine the true effect of the policy on the contracting process. The Naval Postgraduate School submitted a proposal to the DoD Inspector General's office to conduct that study but was underbid for the project by the Defense Manpower Data Center (DMDC). I was to participate in that study as a research assistant on the Naval Postgraduate School's research team. When this opportunity failed to materialize, I decided that a limited survey conducted on a regional basis would still provide valuable insight into the controversy. At the time of this writing, the DMDC nationwide survey is underway. The results of the DMDC study are expected to be released in June 1984.

Since DoDD 7640.2 directly affects contracting officers, auditors, and management within both those communities, it was necessary to collect information directly from them. Because of the controversial nature of the directive, I expected that those practitioners closest to the contract audit process would be hesitant to undergo an interview regarding their opinions. This was true in almost every case. Potential interviewees seemed rather cautious and it

became apparent from the beginning that meaningful participation would depend on an assurance of complete anonymity.

B. THE SAMPLE

Research was limited to personal interviews conducted in California (see Table I, p.16). In addition, there were numerous telephone discussions with management officials in various regional and national headquarters of the Military Departments, Defense Logistics Agency (DLA), and Defense Contract Audit Agency (DCAA). It was primarily through those discussions that potential interviewees were identified. DoD Instruction 4105.59, Directory of Contract Administration Services Components, also provided a list of potentially valuable information sources. Budget and time constraints dictated that interviews be conducted with as many willing participants as possible within a 500 mile radius of the Naval Postgraduate School, Monterey, CA. Selections were not made randomly, nor was there an attempt to establish a statistically valid sample. However, it is the opinion of this researcher that the data provide an accurate and useful insight into the opinions and feelings of those responsible for carrying out the requirements of DoD's contract audit followup policy. I hope that this thesis will assist decision makers in testing their opinions and theories about the effects of the policy on defense contracting.

I completed an extensive review of literature on the subject of conducting interviews. This included studying the psychological aspects of the interviewing process itself in addition to the design and sequence of the questions to be used. In recognizing the psychological implications of dress, I decided it best to wear a military uniform for visits to contracting offices and a business suit for visits

to auditing offices. However, this approach was not possible in every case, since most Plant Representative Offices (PROs) have both contracting and audit personnel assigned.

C. QUESTIONNAIRE DESIGN

I have approximately four years of experience in contracting which proved extremely helpful in formulating questions for the interviews. Nevertheless, it was necessary to closely study both the contracting and auditing processes as a basis for questionnaire design.

The original questionnaire consisted of 54 questions, nearly half of which were open-ended, or free-answer questions. A pre-test of the instrument and interview technique was performed at several offices in the San Francisco Bay area. The initial design of the questionnaire was used to interview at least one individual of each group of respondents (i.e. contracting officers, auditors, and management of each). I explained to those early participants that their knowledge and experience would greatly influence the subsequent design of separate instruments tailored to the concerns, interests, and opinions of their respective communities.

During the pre-test, respondents were encouraged to pursue the discussion of particular aspects of the policy which they felt were important. They were urged to express their understanding of the policy in their own terminology. They were asked to amplify answers to most of the YES/NO and MULTIPLE CHOICE questions in order to test the propriety of those type formats for those questions. Prefatory comments were used to invite the respondent's special consideration to those questions. I was concerned with promoting interaction and avoiding any interrogative tone at this crucial stage of questionnaire development.

As a result of the pre-test, a number of improvements were made:

1. Insight into the need to match interview style with the anticipated personality/culture mix of the groups.
2. The elimination of researcher bias linked to previous contracting experience.
3. The incorporation of terminology more understandable to practitioners.
4. The collection of information needed to develop separate questionnaires for the different groups.
5. The number of open-ended questions reduced to 13.

With the pre-test completed and adjustments made, the remaining interviews were conducted primarily in Los Angeles and Santa Clara County (Silicon Valley), California. Since questionnaires were standardized and tailored to each group, the researcher achieved considerable flexibility in conducting interviews. The structure was very useful where the interviewee's time was limited. Very little probing was used, and most interviews took place in a relaxed atmosphere of cooperation and interested discussion. Despite the structured interview approach and small number of open-ended questions, there were frequently lengthy discussions of many issues.

All personal interviews were conducted within the state of California. Table I lists the breakdown of participants by military department or agency, job title, and grade structure.

In all cases, managers were directly involved with DoDD 7640.2. All managers were responsible for ensuring the timeliness and accuracy of reports and all contracting managers participate in the review process. Within the Defense Logistics Agency and the Navy, managers were members

of Boards of Review. Managers at Air Force offices did not perform any review function since the military commanders serve as the Designated Independent Senior Acquisition Official (DISAO).

TABLE I
Participants

<u>Department/Agency</u>	<u>Job Title</u>	<u>Grade/Rank</u>
Defense Contract Administration Services (DCAS) *	Management/ACO	GM-14
	Management/PA	GS-13
	Management/ACO	GS-13
	Management/ACO	O-4
	Management	O-4
	ACO	GS-13
	ACO	GS-13
	ACO	GS-13
Air Force	Management/PA	GS-12
	PACO	GM-14
	PACO	GM-14
	Management/ACO	GM-14
	Management/ACO	GM-14
	Management/ACO	GM-13
Navy	Management/PA	GS-12
	Management/PCO	GS-14
	PCO	GS-14
	Management/PA	GS-13
	ACO	GS-13
	PCO	GS-13
	ACO	GS-12
Defense Contract Audit Agency (DCAA)	PCO	GS-12
	Management/FAO	GM-14
	Management/FAO	GM-14
	Management/RA	GM-14
	Management/RA	GM-14
	Management/RA	GM-14
	Management/RA	GM-13
	Auditor	GS-12
	Auditor	GS-12

* DCAS is a component of the Defense Logistics Agency.

GM/GS-14:	40%	(12 of 30)
GM/GS-13 (and O-4):	37%	(11 of 30)
GS-12:	23%	(7 of 30)

Note:

Management/ACO: Designates a manager of Administrative Contracting Officers.

Management/PCO: Manager of Procuring Contracting Officers.

Management/PA: Manager of Price Analysts.

ACO: Administrative Contracting Officer.

PCO: Procuring Contracting Officer.

Manager/FAO: Manager of Field Audit Office.

Manager/RA: Manager of Resident Audit Office.

III. PRESENTATION OF FINDINGS

A. EXPLANATION OF TABLES

This chapter provides the reader with an unedited presentation of the findings of the study. Although separate questionnaires were used for the contracting and auditing communities, the first 23 questions of both questionnaires are identical.

Results are presented in tabular form listing the percentage of each group citing a particular response. Column labels are defined as follows:

1. CONTR: The contracting group which includes both contracting officers and contracting managers.
2. AUDIT: The audit group which includes auditors, resident auditors, and audit managers.
3. BOTH: This column represents the percentage of respondents from both groups citing a specific response rather than an average of the two groups.

Many of the open-ended questions induced multiple answers from some participants. However, some participants didn't answer every question, either preferring not to answer or feeling that they couldn't answer. Therefore, percentages do not total 100% for each question.

B. TABLES OF FINDINGS

Table II presents data collected from those questions which are the same on both questionnaires.

Table III presents the data collected from those questions which differed but were designed to seek the same information from the two groups. In many cases, the differences in these groups required that questions be worded differently or perhaps appear in different sequence.

Here the questions are brought together for ease of reference and more meaningful analysis. An "A" precedes auditor questions and a "C" designates contracting questions. Where questions were identical but used in different sequence, the question is presented only once.

Table IV lists the data collected from those questions asked of the contracting group only.

Table V provides the data collected from questions which were only posed to the auditing group.

TABLE II
Results of Common Questions

4. Has the directive been implemented in your organization?

	<u>CONTR</u>	<u>AUDIT</u>
Yes	91%	100%
No	9	0

5. In your own words, what do you believe are the major requirements of the directive, as you see them?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Resolution/disposition of audit reports-----	77%	25%	63%
Tracking of audit reports -----	55	13	43
Periodic status reports -----	50	0	37
Independent review of contracting officer's planned disposition -----	45	25	40
Timeliness of disposition -----	41	38	40
Proper management attention and and action on audit reports -----	23	25	23
Justification by contracting officer for deviations from audit recommendations-----	14	13	13
System integrity; policing -----	5	38	13
Improve audit report useage -----	5	25	10
Evaluation of audit followup system for for compliance with directive -----	5	0	3

Note: This question was intended to have respondents list the requirements they are actually experiencing rather than to restate the directive itself. A prefatory comment was used that asked, "What formal requirements does DoDD 7640.2 impose on you and your organization that weren't officially required before?"

6. How has your job been affected by the requirements of this directive?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Significant administrative impact-----	73%	88%	77%
Additional management time-----	36	88	50
No effect-----	23	13	20
Micro-management/less control by local management-----	18	0	13
Aggravates contracting officer/auditor relationship-----	18	0	13
Significant potential effect-----	18	0	13
Slower negotiation process-----	5	0	3
Confusion about which audit recommendations significant under 5000.42-----	5	0	3

Note: Approximately 50% of all respondents commented that the requirements of 7640.2 were much clearer than 5000.42.

7. Are the objectives which DoD expects to achieve with this directive clear to you?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Yes	77%	100%	83%
No	23		17

8. In your own words, what do you believe is the purpose for DoD issuing the directive?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Perceived need to restore integrity to the system to reverse poor DoD image -----	45%	100%	60%
To ensure faster followup action on overaged audit reports -----	41	0	30
Political pressure (Congress, GAO, DCAA) ----	36	0	27
Better utilization of audit resources via increased CO visibility -----	27	25	27
To give DCAA more clout -----	14	0	10

Note: Prefatory comments emphasized that this question was intended to focus on one main objective, perhaps two at most.

9. Respondents were asked to rank the following six objectives which have been stated in literature on the policy.

	<u>CONTR</u>	<u>AUDIT</u>
To encourage contracting officers to give more heed to the advice of the auditor ----	23.4%	22.5%
To bring potentially troublesome situations to the attention of management for faster resolution -----	22.9	19.8
To require more personal accountability for the financially related decisions which a contracting officer makes -----	18.9	15.9
To require more accountability for the recommendations made in audit reports -----	0	17.0
To require more accountability of management as it relates to the contracting process --	18.1	13.8
To enhance DoD's battle against fraud, waste, and abuse in its procurement system -----	16.7	11.0

10. Do you feel that the directive will achieve these objectives?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Yes	45%	100%	60%
No	55	0	40

11. How do you think the goals of the directive are beneficial?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Improved CO/auditor coordination leading to better problem visibility -----	27%	63%	37%
Management tool for contracting officers ----	36	13	30
Goals are admirable, but directive not needed. Goals stated elsewhere -----	23	13	20
No benefit -----	23	0	17
Improve timeliness of decision-making -----	18	13	17
Potential cost savings -----	14	25	17
Increases CO accountability which produces better supported decisions -----	0	38	10
Better supported DCAA reports -----	5	13	7

12. How do you think the goals of the directive are not beneficial?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
More administrative burden, bureaucratic growth potential -----	32%	13%	27%
Can't see any negative effects -----	14	63	27
Adverse effect on Contracting Officer's authority & business judgment -----	27	13	23
A system to second-guess the Contracting Officer -----	27	0	20
More management time for questionable benefit since requirements already exist -----	14	13	13
Overemphasis on quick resolution -----	14	0	10
Negative effect on Contracting Officer/Auditor relationship -----	5	13	7

13. Were any formal contract audit follow-up procedures used in your organization prior to 7640.2?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Yes	36%	88%	50%
No	64	12	50

14. Prior to 7640.2, did you use some personal method of follow-up for audit reports that contained unresolved recommendations?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Yes	45%	13%	37%
No	18	0	13

15. In your opinion, were these procedures effective in stressing the importance of audit recommendations?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Yes	59%	38%	53%
No	41	62	47

16. In your opinion, how has directive 7640.2 affected the independent, decision-making authority of the contracting officer?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Weakened it -----	55%	25	47%
No effect -----	36	75	47
Strengthened it -----	9	0	6

17. Would you please explain your opinion including why you believe such an impact is or is not important.

<u>Weakened</u>	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Contracting Officer must elevate significant audit issues which encourages less responsibility for decisions -----	36%	25%	33%
Auditor's power overemphasized -----	27	0	20
Contracting Officer frustration from administrative burden. Less time for other important tasks -----	5	0	3

<u>No effect</u>			
Contracting Officer has same contractual authority, but less arbitrary -----	45%	50%	47%
Contracting Officer still has the responsibility for contractual decisions -----	14	50	23
Only impact is administrative -----	14	0	10
Significant actions have always been reviewed by senior acquisition official ----	5	0	3

<u>Strengthened</u>			
Causes the Contracting Officer to more carefully "think through" and document decisions -----	9%	0	6%

18. In your opinion, how has the authority of the DCAA auditor been affected by directive 7640.2?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Strengthened auditor's role or influence vis-a-vis the Contracting Officer -----	59%	50%	57%
No effect on authority; auditor still has same advisory role and responsibilities ---	45	50	47
Dislike term "authority" which implies that auditor has contractual authority -----	14	25	17

19. Before the implementation of 7640.2, what percentage of audits in your organization involved significant differences of opinion between the contracting officer and the contract auditor?

	<u>CONTR</u>	<u>AUDIT</u>
Insignificant/quite small	100%	--

20. What is now the percentage of audits containing these differences of opinion between contracting officer and contract auditor?

	<u>CONTR</u>	<u>AUDIT</u>
Insignificant/quite small	100%	--

21. In your opinion, when is the proper time to consider audit recommendations as resolved?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
After negotiations when the Contracting Officer reaches agreement with the contractor -----	50%	50%	50%
When the Contracting Officer makes decision either before or during negotiations -----	41	25	33
When contractor corrects deficiency or implements audit recommendations -----	9	25	13
Varies according to type of audit -----	14	0	10
When Auditor and Contracting Officer settle differences -----	9	0	7
When DISAO or Review Board approves of the Contracting Officer's position -----	5	13	7

22. As a result of the directive 7640.2, audit reports are resolved:

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Much quicker -----	0%	13%	3%
Somewhat quicker -----	23	38	27
No change -----	54	38	50
Somewhat slower -----	14	13	13
Much slower -----	9	0	0

23. In your view, has this change been of benefit to the Government?

	<u>CONTR</u>	<u>AUDIT</u>
<u>Much quicker</u>		
Yes	0%	100%
No	0	0
<u>Somewhat quicker</u>		
Yes	80	100
No	20	0
<u>Somewhat slower</u>		
Yes	67	0
No	33	100
<u>Much slower</u>		
Yes	0	0
No	100	0

TABLE III
Results of Comparable Questions

A 24. How many differences of opinion have you had elevated to
C 25. an official or board in the last 6 months?

<u>CONTR</u>	<u>AUDIT</u>
13	3

A 25. What percentage of senior official/board written recommendations have been in agreement with or supported the contracting officer's position?

C 26. What percentage of senior official/board written recommendations have been in agreement with the auditor?

	<u>CONTR</u>	<u>AUDIT</u>
Percentage in agreement with auditor -----	0%	
Percentage in agreement with Contracting Officer -----		100%

A 28. Prior to the advent of 7640.2, when a contracting officer disagreed with your recommendations, did he usually explain his position?

	<u>AUDIT</u>
Yes	38%
No	62

C 31. Before 7640.2, when you disagreed with the auditor's recommendations, did you usually explain your position to the auditor?

	<u>CONTR</u>
Yes	100%
No	0

C 32. Do you now generally resolve such disagreements with the auditor without going to a review official or board?

	<u>CONTR</u>
Yes	68%
No	32

A 29. Do you usually find it easy to establish good rapport with most contracting officers?

AUDIT

Yes	88%
No	12

C 33. Have you been able to establish good rapport with most contract auditors that you've dealt with?

CONTR

Yes	95%
No	5

A 30. What changes if any have you noticed in the attitudes of contracting officers that could be linked to the implementation of this directive?

AUDIT

Contracting Officers more willing to discuss positions with DCAA -----	63%
No change in attitude -----	25
Contracting Officers more adversarial -----	25
Contracting Officers dislike the directive -----	12

C 34. What changes if any have you noticed in the attitudes of auditors that could be linked to the implementation of this directive?

CONTR

No change in attitude -----	72%
Auditors less hesitant to ensure Contracting Officers comply with directive; more probing ----	9
Auditors concerned that policy causes more rifts between them and Contracting Officers -----	9
Auditors more concerned that audit is defensible --	9

A 34. What differences, if any, have you noticed in contractors' proposals as a result of directive 7640.2?

<u>CONTR</u>	<u>AUDIT</u>
--------------	--------------

No change	100%	100%
-----------	------	------

A 35. Before the implementation of 7640.2, how often were you asked to settle a disagreement directly with a contractor?

C 43. Before the implementation of 7640.2, how often did you ask a contractor to settle a disagreement directly with an auditor?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Occasionally -----	25%	63%	36%
Never -----	45	0	30
Rarely -----	25	25	25
Frequently -----	5	12	7
Always -----	0	0	0

A 36. In your opinion, when is it advisable for an auditor and the contractor to deal directly in seeking to settle disagreements on audit recommendations?

AUDIT

When there are questions of fact, i.e. accounting system (& other system) deficiencies, incurred costs, defective pricing, etc ----- 100%

C 45. Do you think it's good to ask a contractor to settle audit recommendations with an auditor?

CONTR

Yes 35%
No 65

A 37. How has the implementation of directive 7640.2 changed the type of costs which an auditor would question?

C 46. How has directive 7640.2 changed the type of costs questioned by auditors?

CONTR AUDIT

No changes 100% 100%

A 38. In your organization, has there been any documented recovery of public funds attributable to the provisions of 7640.2?

C 49.

CONTR AUDIT

Yes 0% 12%
No 100 83

A 39. To your knowledge, has 7640.2 had any effect on the percentage of disputes which have been appealed to the ASBCA or courts?

C 50. Is there any evidence that 7640.2 is affecting the frequency of contractors' appeals to ASBCA or court?

	<u>CONTR</u>	<u>AUDIT</u>
Yes	0	0
NC	100%	100%

A 40. What would you recommend?

C 52:

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Cancel the directive -----	54%	12%	43%
Make no changes -----	14	88	34
Change the directive	32	0	23

TABLE IV

Results of Contracting Officer Questions

C 24. Which of the following does your organization use for management review of differences of opinion?

CONTR

Senior officials only -----	33%
Boards only -----	29
Both of these -----	38

C 27. How has the directive affected the way you negotiate?

CONTR

No effect -----	50%
Less effective negotiations from divided Government position which contractor can exploit -----	27
Less effective negotiations due to less time for planning and delays -----	23

C 28. What percentage of major negotiations in which you have participated also included the auditor as a participant?

CONTR

Respondents who said 100% -----	50%
Respondents who said 10 - 5% -----	18
Respondents who said none -----	18
Respondents who said 70 - 30% -----	14

C 29. Did the auditor's participation generally prove to be helpful?

CONTR

Yes	83%
No	17

C 30. What is your opinion about auditors participating in negotiations with a contractor?

CONTR

A good idea only if auditor realizes that the Contracting Officer is the team leader -----	41%
Auditors participation is generally helpful -----	36
Auditor's participation is of some value depending on the situation -----	23
Auditor's participation is absolutely essential due to tactical importance as financial expert --	18

C 35. Has this directive improved your use audit reports?

CONTR

Yes	9%
No	91

C 36. What key things do you look for in deciding whether an audit report is good?

CONTR

Quality of documentation and support of findings ---	67%
Responsiveness to audit request and sufficient depth of review to facilitate negotiations -----	23
Reputation of auditor or DCAA office -----	14
Topic of report -----	9
Assume every audit report is good -----	9
Timeliness -----	5

C 37. How would you judge the average quality of DCAA audit reports?

CONTR

Good -----	77%
Marginal -----	14
Very good -----	5
Quite poor -----	5
Poor -----	0

C 38. Do you believe that the overall quality of DCAA audit reports has improved as a result of directive 7640.2?

CONTR

Yes	5%
No	95

C 40. When you disagree with an auditor's opinion, how often do you feel that it's best for everyone concerned to concede the issue?

CONTR

Never -----	38%
Occasionally -----	31
Rarely -----	25
Always -----	6
Frequently -----	0

C 41. When you disagree with the opinion of a review board or official, how often are you willing to defend you position against every challenge?

CONTR

Always -----	50%
Frequently -----	33
Occasionally -----	11
Rarely -----	6
Never -----	0

C 42. How often do you feel compelled to avoid potentially controversial issues by passing a decision to a review board or official?

CONTR

Never -----	68%
Occasionally -----	16
Rarely -----	16
Frequently -----	0
Always -----	0

C 44. Since the implementation of 7640.2, how often have you asked the contractor to settle a dispute with the auditor?

CONTR

Never -----	63%
Occasionally -----	16
Rarely -----	16
Frequently -----	5
Always -----	0

C 47. Have you experienced any delay in procurement as a direct result of 7640.2?

CONTR

Yes	14%
No	86

C 48. Do you believe that the overall effect of this delay has been to the Government's advantage?

CONTR

Yes	33%
No	67

C 51. Have you experienced any new difficulty in the negotiation of subcontracts since the implementation of 7640.2?

CONTR

No 100%

TABLE V
Results of Auditor Questions

A 26. How often have you participated in negotiations with contractors that you have audited?

<u>AUDIT</u>	
Occasionally -----	50%
Seldom -----	50

A 27. Do you feel that auditors should participate in more negotiations?

<u>AUDIT</u>	
Yes	100%

A 31. In your view, has this directive affected the quality of DCAA audit reports?

<u>AUDIT</u>	
Yes	33%
No	67

A 32. What key things determine whether an audit report is effective?

<u>AUDIT</u>	
The extent to which recommendations are sustained in the negotiations -----	75%
Must be completely accurate and sufficiently detailed -----	63
Must be useful to the negotiator, i.e. understandable, supportable, flexible -----	50
Adequate timeliness to permit consideration of findings -----	13

A 33. In your opinion, has 7640.2 improved the effectiveness of audit reports?

<u>AUDIT</u>	
Too soon to tell ----	50%
Yes -----	38
No -----	12

IV. IMPLEMENTATION OF DIRECTIVE

A. MAJOR REQUIREMENTS

Department of Defense Directive 7640.2 states:

Contracting officers and acquisition management officials shall pursue timely resolution and disposition of contract audit reports. Resolution of contract audit reports by law is required within 6 months of issuance, and disposition normally shall be completed within 6 months. The contract audit followup system shall be structured in consonance with the independent decision-making role of the contracting officer and the financial advisory role of the contract auditor [Ref. 2].

In attempting to achieve the timely resolution and disposition of audit reports, both DoDD 7640.2 and its predecessor, DoDD 5000.42 set forth essentially the same major requirements:

1. Tracking by the contracting officer of all contract audit reports.
2. Status reporting of specified contract audit reports to DoD's Inspector General.
3. Senior management review of differences between contracting officers and auditors.
4. Evaluation of effectiveness of the followup system employed by each DoD component.

Question 5 of Table VI was intended to explore the possibility of any emergent requirement not officially stated in the directive by focusing on the practitioner's perspective of that issue. However, Table VI shows that most participants were comfortable with simply repeating the officially stated requirements of the directive, i.e., the tracking, reporting, and timely resolution of audit reports, and independent review of the contracting officer's position

TABLE VI
Major Requirements

5. In your own words, what do you believe are the major requirements of the directive, as you see them?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
a. Resolution/disposition of audit reports-----	77%	25%	63%
b. Tracking of audit reports -----	55	13	43
c. Periodic status reports -----	50	0	37
d. Independent review of contracting officer's planned disposition -----	45	25	40
e. Timeliness of disposition -----	41	38	40
f. Proper management attention and action on audit reports -----	23	25	23
g. Justification by contracting officer for deviations from audit recommendations-----	14	13	13
h. System integrity; policing -----	5	38	13
i. Improve audit report useage -----	5	25	10
j. Evaluation of audit followup system for compliance with directive -----	5	0	3

by senior acquisition officials. No additional requirement appears in the responses. But 63% of the auditors and 10% of the contracting group took this early opportunity in the interview to express what they believed were some of the objectives of the followup policy, as indicated by responses (h) and (i) of Table VI.

B. FOLLOWUP PRIOR TO DODD 7640.2

The questions in Table VII were intended to ascertain whether there were any procedures for following up on contract audit reports prior to 7640.2 (other than 5000.42).

Responses to question 13 indicate that there were some formal procedures for contract audit followup in existence prior to DoDD 7640.2. In addition, as the responses to question 14 show, many (45%) of the contracting group used

TABLE VII

Followup Procedures Prior to 7640.2

13. Were any formal contract audit followup procedures used in your organization prior to 7640.2?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Yes	36%	88%	50%
No	64	12	50

14. Prior to 7640.2, did you use some personal method of followup for audit reports that contained unresolved recommendations?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Yes	45%	13%	37%
No	18	0	13

15. In your opinion, were these procedures effective in stressing the importance of audit recommendations?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Yes	59%	38%	53%
No	41	62	47

some personal method of followup. The contracting group referred to reports used to track the status of specified audit reports such as defective pricing audits, overhead audits, and Cost Accounting Standards (CAS) compliance audits. Auditors referred to DCAA's Contract Audit Manual (CAM), which provides auditors with guidance for pursuing the status of audit reports. However, auditors were quick to point out that the CAM provides nothing which will ensure that contracting officers give auditors the feedback that they desire. Question 15 frequently met with long pauses and appeared to be a difficult answer for most participants, particularly the contracting group. Many of those answering

"yes" believed that the existing procedures were only successful to some extent. Auditors who answered "no" emphasized that feedback from contracting officers, if received at all, was usually late and came after repeated attempts to acquire such information.

C. JOB IMPACT

Table VIII shows that the greatest impact on the participants' jobs has been an increase in administrative

TABLE VIII
Job Impact

6. How has your job been affected by the requirements of this directive?			
	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
a. Significant administrative impact	73%	88%	77%
b. Additional management time-----	36	88	50
c. No effect-----	23	13	20
d. Micro-management/less control by local management-----	18	0	13
e. Aggravates relationship between contracting officer and auditor --	18	0	13
f. Significant potential effect-----	18	0	13
g. Slower negotiation process-----	5	0	3
h. Confusion about which audit recommendations significant under DoDD 5000.42-----	5	0	3

requirements. Most of the offices visited complained that administrative resources were strained before DoDD 7640.2 and felt that the additional administrative burden of the directive has enlarged the problem. Three respondents of the audit group felt that DCAA's reporting requirements were duplicative and unnecessary. Half of the respondents are troubled by the additional management time demanded by the directive.

The current Presidential administration has espoused a general policy of less paperwork in government. Executive Order 12352 of March 17, 1982, addressed the reduction of administrative costs in the procurement system by charging the heads of executive agencies with the responsibility to:

Establish programs to reduce administrative costs and other burdens which the procurement function imposes on the Federal Government and the private sector. Each program shall take into account the need to eliminate unnecessary agency procurement regulations, paperwork, reporting requirements....and other administrative procedures. [Ref. 4]

Congress demonstrated a similar intent by passing into law such measures as the Paperwork Reduction Act. Nevertheless, several interviewees believed that DoD's contract audit followup policy had a good chance to be expanded. One Navy manager pointed out that when the policy first appeared as DoDD 5000.42, the tracking and reporting requirements applied only to certain specified audit reports that contained significant differences between the contracting officer and the contract auditor. DoDD 7640.2 now requires the tracking of all audit reports, but has eliminated the reporting requirement for certain types of audit reports, a revision that DoD has predicted will reduce the administrative burden of the followup procedures.

Although DoDD 7640.2 requires that only certain outstanding audit recommendations be reported, there was a sense of apprehension among many practitioners that this requirement might be expanded. The Air Force seems to be preparing for this possibility by developing a computerized system to handle the tracking and reporting requirements. The system will be called the Contracting Officer's Information Network (COIN) and is expected to ease the administrative burden of the contracting officer.

Sixty-four percent of the contracting group (responses d through h of Table VIII) pointed out additional effects of the directive on their jobs. Several expressed regret that the auditor/contracting officer relationship has been adversely affected. One ACO put it this way: "The policy can't change human nature, although it may affect it some. Where the relationship is good there should seldom be disagreement. However, where there is little or no communication, or where the communication is ineffective, there is much room for disagreement." It is interesting to note that the relationship between the contracting officer and the auditor has been a source of concern for many within DoD since the Defense Contract Audit Agency was formed in 1965 [Ref. 5].

The involvement of management in the details of following up on audit reports was also disturbing to 18% of the contracting group. They considered it to be a clear signal from top government officials that they lacked confidence in the contracting work force. An Air Force Principal Administrative Contracting Officer (PACO) explained his feelings. "There is a perceived need for contracting officers to give more heed to audit advice. If I decide not to use the auditor's advice, I have to justify my decision to the DISAO."

D. EMOTIONAL ASPECTS

Controversial issues generally provoke emotion, and DoDD 7640.2 is no exception. The responses listed in Table IX demonstrate this fact. When asked if their organizations had implemented the directive, two respondents (9%) of the contracting group answered "no" despite the fact that implementation has taken place in their organizations. Their familiarity with the directive and the tone of the

TABLE IX
Impact of Implementation

4. Has the directive been implemented in your organization?

	<u>CONTR</u>	<u>AUDIT</u>
Yes	91%	100%
No	9	0

discussions made this quite clear. Although they would not clarify their answers, they were obviously making an emotional statement that they did not see the need for the directive. If left to them, the directive would not have been issued.

Table X brings more focus to the question of whether practitioners feel a need for the contract audit followup

TABLE X
Do We Need DoDD 7640.2?

A 40. What would you recommend?
C 52.

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Cancel the directive -----	54%	12%	43%
Make no changes -----	14	88	34
Change the directive -----	32	0	23

policy. Seven of the audit participants (88%) felt that the directive is needed and believed that the directive will clearly demonstrate its value in the next two years.

Auditors generally agreed that the increase in administrative requirements were worth the price, predicting that the benefits of the policy will far outweigh its costs.

Only three of the contracting group (14%) share the auditors' optimism. The majority opinion is best described by the following response from a DCAS manager:

The directive doesn't meet the cost/benefit acid test. The costs far outweigh the benefits, if indeed there are any benefits. The theory of avoiding delay in settling tough pricing issues is sound. It's the way of doing business for every conscientious contracting officer I know. One of the key issues is that the competency level of the procurement work force doesn't change because of the policy. There may be an argument for the policy's influence on the pre-negotiation position being improved, since management is called in for advice and recommendations. However, this applies only to DCAS since the services already have formalized policy on developing pre-negotiation positions with the aid of management. Not only does the policy fail to achieve what it presumes to achieve, but it calls attention to the inadequacy of the work force in dealing with tough decisions.

Most of the contracting group believed that DoDD 7640.2 instituted a system of micro-management, i.e., top management involving itself in management details which properly belong to middle managers. Those favoring a change in the directive also were most concerned about the micro-management implications. Although in agreement with the need to reduce the number and incidence of overaged audit reports, they were not in agreement with the directive's procedures aimed at achieving that goal.

V. POLICY OBJECTIVES AND RESULTS

A. OBJECTIVES

Table XI represents the views of participants with regard to the objectives of DoDD 7640.2 and the extent to which those objectives might be achieved. Question 7 indicates that 83% of all respondents believed that the directive's objectives were clear. However, it is interesting to contrast the responses to question 8 with those of question 9. That difference suggests that a clear statement of policy objectives has yet to be fully communicated to practitioners. Question 8 asks for policy objectives in the words of the respondent, while question 9 asks the respondent to rank objectives which have been identified by Government officials in the literature on DoDD 7640.2.

Question 8 shows that 60% of all respondents believed that DoD's procurement system is suffering from an image of questionable integrity. There was mention of the "horror stories" and bad press that have brought increasing criticism and political pressure to bear on DoD policy makers. One contracting manager claimed that he attended a speech given by former Assistant Deputy Under Secretary of Defense (Acquisition Policy) Robert Trimble in which Mr. Trimble said that DoDD 5000.42 was issued to please Congressman Brooks (D-Texas). According to this respondent, Mr. Trimble implied that the directive was hastily put together at the last minute, receiving very little coordination below top management level. This view tends to support the opinion of many of the respondents that DoDD 7640.2 is a significant improvement over DoDD 5000.42 in terms of clarity. One audit manager expressed it this way:

TABLE XI
Participants' Views on Objectives

7. Are the objectives which DoD expects to achieve with this directive clear to you?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Yes	77%	100%	83%
No	23		17

8. In your own words, what do you believe is the purpose for DoD issuing the directive?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
a. Perceived need to restore integrity to the system to reverse poor DoD image -----	45%	100%	60%
b. To ensure faster followup action on overaged audit reports -----	41	0	30
c. Political pressure (Congress, GAO, DCAA) -----	36	0	27
d. Better utilization of audit resources via increased contracting officer visibility -----	27	25	27
e. To give DCAA more clout -----	14	0	10

9. Respondents were asked to rank the following six objectives which have been stated in literature on the policy.

	<u>CONTR</u>	<u>AUDIT</u>
a. To encourage contracting officers to give more heed to the advice of the auditor -----	23.4%	22.5%
b. To bring potentially troublesome situations to the attention of management for faster resolution -----	22.9	19.8
c. To require more personal accountability for the financially related decisions which a contracting officer makes -----	18.9	15.9
d. To require more accountability for the recommendations made in audit reports -	0	17.0
e. To require more accountability of management as it relates to the contracting process -----	18.1	13.8
f. To enhance DoD's battle against fraud, waste, and abuse in its procurement system -----	16.7	11.0

10. Do you feel that the directive will achieve these objectives?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Yes	45%	100%	60%
No	55	0	40

I think 7640.2 is a great improvement over 5000.42 which was so hastily thrown together that it created a lot of consternation within the contracting community. Perhaps if 5000.42 had not been issued first, 7640.2 would be received a lot better.

A substantial number (41%) of the contracting group believed that faster followup action was a primary aim of the policy (response 8-b). The timeliness issue was a common thread that ran throughout the course of most interviews. The concern for timeliness is apparently due to the provision which Congress included in its passage of P.L. 96-304 requiring resolution of all federal audit reports within 6 months of issue.

Thirty-six percent of the contracting group recognized that, in order to improve its credibility with Congress, DoD needs to respond to the political pressure for improvement in specific areas. One contracting officer said that "DoD needs to dispose of a large number of outstanding audit reports to give Congress the impression that we have done something to control costs. This would certainly help to mitigate the negative implications of reports made to Congress by the General Accounting Office."♦

Perhaps the most interesting result of question 9 was the tendency of both groups to give a lower ranking to the accountability of practitioners. These responses appear to be a psychological way of dealing with the perception that more accountability is expected from them. That interpretation of the responses becomes even more probable when considering that management's involvement was thought to be important (response 9-b), but not management's accountability (response 9-e). The apparent paradox may be the result of the confusion between the requirements of DoDD 7640.2 and its predecessor, DoDD 5000.42. One of the

♦See chapter I, p.7

provisions of DoDD 5000.42 required senior acquisition management (DISAO) to take a "clear position" on disagreements and issue a written statement of such position to the contracting officer. DoDD 7640.2 has somewhat softened its language in this area so that the DISAO acts more as an adviser than a decision maker. However, the role of the DISAO still seems unclear.

The emphasis on timeliness of resolution was expected and is comparable to the similar emphasis found in response to question 8. It is surprising that response 9(f) was not rated higher since "enhancing DoD's battle against fraud, waste, and abuse" is a popular phrase found in the literature on audit followup.

Question 10 contrasts the cohesiveness of the auditing group with the split in the contracting group. All of those answering "no" made it clear that some of the objectives might be achieved, but not all of them. The 60% answering "yes" failed to make this distinction, which appears unrealistic. Of those who qualified their "yes" answers, there was a general belief that all objectives would be achieved to a certain extent, some more than others. One auditing manager did say that achieving all of the policy's objectives would depend on how well DoD's Inspector General (DoDIG) enforces compliance with the directive. The DoDIG followup to ensure compliance is one of the major stated requirements of DoDD 7640.2.

Those less confident in the directive's ability to achieve its objectives were more outspoken. One Defense Contracts Administration Service (DCAS) ACO expressed this opinion:

The competent contracting officer has always given appropriate attention to audit, and in those cases where he disagrees, has done so for good, sound reasons. The directive can't improve this. For the less competent contracting officer, the directive still doesn't change anything since he always has relied heavily on audit

advice and will continue to do so rather than challenge audit recommendations.

Another DCAS Manager/ACO had this to say:

Contracting officers have always given heed to the auditor. They have always been personally accountable for their decisions, and management has always been accountable to a certain extent for their decisions. This won't change either. All of this is political nonsense.

B. RESULTS

1. Resolving Significant Differences

Table XII indicates that DoDD 7640. 2 has had no appreciable effect on the number of significant differences between contracting officers and auditors. However, there may still be some confusion among practitioners with respect to what constitutes a "significant difference" since 7640.2 revised the definition. Regardless of the definition, it is apparent that the majority of contracting officers dispose of audit reports by agreeing with the major findings of auditors. Auditors most frequently responded to questions 19 and 20 by saying that no statistics are available on the issue. However, in the words of one audit manager, "DCAA on the whole has experienced a 65% sustention rate on its recommendations. This means that 65% of the auditor's recommendations have been incorporated into the contract." Since the "give and take" of contract negotiations usually require a pre-negotiation position higher than the desired settlement, the 65% sustention experience of DCAA suggests that contracting officers have generally entered into negotiations with a percentage of agreement with audit advice higher than the 65% sustention rate. This finding compares

TABLE XII
Significant Differences

19. Before the implementation of 7640.2, what percentage of audits in your organization involved significant differences of opinion between the contracting officer and the contract auditor?

	<u>CONTR</u>	<u>AUDIT</u>
Insignificant/quite small	100%	*

20. What is now the percentage of audits containing these differences of opinion between contracting officer and contract auditor?

	<u>CONTR</u>	<u>AUDIT</u>
Insignificant/quite small	100%	*

* No statistics available

favorably with the contracting group's responses to questions 19 and 20.

2. Speed of Resolution

Table XIII indicates that the majority of respondents (50%) believed that DoDD 7640.2 has had no effect on the speed of resolution. Many respondents felt that the policy was too new to determine its true effect in this area. One auditor said that quicker resolution of differences of opinion will occur only if the policy is followed. There were no respondents who disagreed with the principal goal of reducing the number of overaged audit reports. However, a significant number of the contracting group pointed out that quicker resolution of differences between the contracting officer and auditor does not always result in quicker disposition of the audit report itself.

TABLE XIII
Change in Speed of Resolution

22. As a result of the directive 7640.2, audit reports are resolved:

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Much quicker -----	0	13%	3%
Somewhat quicker-----	23	38	27
No change -----	54	38	50
Somewhat slower -----	14	13	13
Much slower -----	9	0	0

Additionally, it was pointed out that quicker disposition of audit reports does not always serve the government's best interests, an issue which is discussed later.

3. Independent Reviews

Table XIV indicates a total of 16 audit actions elevated to a DISAO or Board for independent review. This figure may be slightly overstated since it is possible that references to elevated actions coming from the different groups pertain to the same audit report. The most striking feature of Table XIV is that all of the reviews have been decided in favor of the contracting officer's position.

Several of the auditors questioned whether the so-called "independent" management review of the contracting officer's position really achieves a completely impartial assessment of the differences in opinion between the auditor and contracting officer. Their suspicion may be warranted in view of the fact that 100% of the elevated actions reported have gone in favor of the contracting officer. Several contracting officers commented on the tendency of senior management to approve the contracting officer's position. The reasons given were:

TABLE XIV
DISAO/Board Independent Reviews

A 24. How many differences of opinion have you had
C 25. elevated to an official or board in the last
6 months?

<u>CONTR</u>	<u>AUDIT</u>
13	3

A 25. What percentage of senior official/board written
recommendations have been in agreement with or
supported the contracting officer's position?

C 26. What percentage of senior official/board written
recommendations have been in agreement with the
auditor?

	<u>CONTR</u>	<u>AUDIT</u>
Percentage in agreement with auditor -----	0%	
Percentage in agreement with Contracting Officer -----		100%

1. Management's lack of experience with the contracting system (primarily cited for military officers).
2. Management's unfamiliarity with the specific procurement action in question.
3. The need for expediency, i.e., avoiding delays and complications in the organization's procurement mission.
4. The advice of other technical experts favored the contracting officer over the auditor.

However, it should be noted that the directive offers the auditor an avenue of recourse:

The Director, Defense Contract Audit Agency (DCAA) shall...monitor all final disposition and negotiation memoranda received. When the memoranda indicate that a pattern of substantial differences of opinion exists on

the disposition of contract audit reports, whether the contracting officer did or did not request reviews by the DISAO, the contract audit field office auditor shall refer the matter to the cognizant DCAA regional director [Ref. 2: F-7.b.].

4. Direct Effect on Contractors

The data in Table XV indicate that there are no effects from DoDD 7640.2 directly traceable to defense contractors. One Air Force contracting manager believed that most contractors are not aware of the directive's requirements. However, one respondent in the audit group indicated that contractors seem to be responding a little more quickly to audit reports than in the past. In view of the stand taken against the policy by two major industry associations,⁵ it would be misleading to say that contractors aren't aware of the directive.

The responses to questions A39 and C50 are surprising in view of the predictions that were made when the policy was first introduced as DoDD 5000.42 in August of 1981. Because of the provisions of the Contract Disputes Act of 1978,⁶ there were many who expected a substantial increase in the litigation of contractual disputes. Since the audit followup policy was expected to cause contracting officers to issue more final decisions in agreement with the auditor, it was believed that more appeals would result. However, the data show that this has yet to be a problem. Another interesting aspect to these responses is that no one interviewed mentioned that there was potential for increased litigation, despite its being a reasonable expectation.

⁵The Electronic Industries Association (EIA) and The National Security Industrial Association (NSIA)

⁶The Disputes Act provides government contractors with the right to appeal the final decisions of contracting officers.

TABLE XV
Direct Effects on Contractors

A 34. What differences, if any, have you noticed in
C 39. contractors' proposals as a result of 7640.2?

	<u>CONTR</u>	<u>AUDIT</u>
No change	100%	100%

A 37. How has the implementation of directive 7640.2 changed the type of costs which an auditor would question?

C 46. How has directive 7640.2 changed the type of costs questioned by auditors?

	<u>CONTR</u>	<u>AUDIT</u>
No changes	100%	100%

A 39. To your knowledge, has 7640.2 had any effect on the percentage of disputes which have been appealed to the ASBCA or courts?

C 50. Is there any evidence that 7640.2 is affecting the frequency of contractors' appeals to ASBCA or court?

	<u>CONTR</u>	<u>AUDIT</u>
Yes	0	0
No	100%	100%

5. Contractor-Auditor Disagreements

The questions appearing in Table XVI were intended to test the effect of DoDD 7640.2 on the frequency and propriety of direct settlements of disagreements between contractors and auditors. Because of an oversight, auditors were not asked a followup question to A35.

The responses to questions A36 and C45 show that there are situations in which disagreements are best settled

TABLE XVI
Contractor-Auditor Disagreements

A 35. Before the implementation of 7640.2, how often were you asked to settle a disagreement directly with a contractor?

C 43. Before the implementation of 7640.2, how often did you ask a contractor to settle a disagreement directly with an auditor?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Occasionally -----	25%	63	36%
Never -----	45	0	30
Rarely -----	25	25	25
Frequently -----	5	12	7
Always -----	0	0	0

C 44. Since the implementation of 7640.2, how often have you asked the contractor to settle a dispute with the auditor?

	<u>CONTR</u>
Never -----	63%
Occasionally -----	16
Rarely -----	16
Frequently -----	5
Always -----	0

A 36. In your opinion, when is it advisable for an auditor and the contractor to deal directly in seeking to settle disagreements on audit recommendations?

AUDIT

When there are questions of fact, i.e. accounting system (G other system) deficiencies, incurred costs, defective pricing, etc ----- 100%

C 45. Do you think it's good to ask a contractor to settle audit recommendations with an auditor?

	<u>CONTR</u>
Yes	35%
No	65

directly between the auditor and contractor. Comments from the contracting respondents answering "yes" to question C45 are in agreement with the auditing group's response to question A36. As one Navy PCO put it:

Where there are issues of fact to be settled, these should be dealt with prior to negotiations. If they (auditor and contractor) can settle, it avoids being an issue. To say "no" would imply that the contracting officer is always capable of achieving a superior decision.

The percentage of those contracting respondents who never ask for direct settlement rose from 45% (question C43) to 63% (question C44) after the implementation of DoDD 7640.2. There are times when direct settlements between auditor and contractor are appropriate, as the response to question A36 indicates. But there is no apparent explanation for the number of requests for direct settlements to decrease. Perhaps the responses to questions C44 and C45 are a reflection of the contracting officer's frustration or disappointment in the ascension of the auditor's role.

6. Quality and Effectiveness of Audit Reports

As Table XVII indicates, the overwhelming majority of respondents believed that the directive had no effect on the quality of DCAA audit reports. The auditors who answered "yes" to question A31 gave qualified answers. They stressed the need for audit reports to be of unquestionable integrity and accuracy due to the potential for disagreements with contracting officers. However, they were quick to add that an unqualified "yes" would suggest that DCAA audit reports have not always been of the highest quality.

Question A32 (response a) of Table XVIII highlights the importance that 75% of the auditors attached to the sustention of their recommendations in negotiations. To

TABLE XVII

Effect on Quality of Audit Reports

- A 31. In your view, has this directive affected the quality of DCAA audit reports?

AUDIT

Yes	33%
No	67

- C 37. How would you judge the average quality of DCAA audit reports?

CONTR

Good	-----	77%
Marginal	-----	14
Very good	-----	5
Quite poor	-----	5
Poor	-----	0

- C 38. Do you believe that the overall quality of DCAA audit reports has improved as a result of 7640.2?

CONTR

Yes	5%
No	95

this end, 50% of the auditors stressed the utility of audit reports, including accuracy and flexibility as essential characteristics that make an audit report useful in negotiating a fair and reasonable price. In comparison, a relatively small number (23%) of the contracting group cited the usefulness of audit reports in negotiations (C36, response b) as a criterion for deciding the value of an audit report. However, 67% named (1) the quality of documentation, and (2) the support for findings, both of which are fundamental requirements for successful negotiation.

The issue of timeliness seems to command considerable attention in much of the written material concerning

TABLE XVIII
Audit Report Effectiveness

A 32. What key things determine whether an audit report is effective?

AUDIT

a. The extent to which recommendations are sustained in the negotiations -----	75%
b. Must be completely accurate and sufficiently detailed -----	63
c. Must be useful to the negotiation, i.e. understandable, supportable, flexible -----	50
d. Adequate timeliness to permit consideration of findings -----	13

A 33. In your opinion, has 7640.2 improved the effectiveness of audit reports?

AUDIT

Too soon to tell ----	50%
Yes -----	38
No -----	12

C 35. Has this directive improved your use audit reports?

CONTR

Yes	9%
No	91

C 36. What key things do you look for in deciding whether an audit report is good?

CONTR

a. Quality of documentation and support of findings -----	67%
b. Responsiveness to audit request and sufficient depth of review to facilitate negotiations ---	23
c. Reputation of auditor or DCAA office -----	14
d. Topic of report -----	9
e. Assume every audit report is good -----	9
f. Timeliness -----	5

contract audit. In literature and correspondence on the topic, the predominant view seems to be that audit reports

must be timely to be effective. However, it is interesting to find that both groups considered the timeliness of an audit report to be relatively insignificant in determining its effectiveness. Better than 80% of the contracting group were satisfied with the quality of DCAA audit reports (Table XVII), which would suggest that they were similarly satisfied with the timeliness with which they receive the reports. This issue should not be confused with that of the timeliness of resolution between auditors and contracting officers.

There was a marked difference of opinion regarding the influence of DoDD 7640.2 on the effectiveness of audit reports. While 38% of the auditors believed that the directive has improved audit report effectiveness, only 9% of the contracting group reported that the directive had increased their use of audit reports. Auditors appeared optimistic about this issue since 50% of those surveyed said that it was too soon to tell whether there will be an impact on effectiveness. Although the consensus among auditors was that audit effectiveness will increase as time passes, there was no evidence that this has yet taken place.

C. BENEFITS AND DETRIMENTS

Table XIX illustrates that DoDD 7640.2, to this point, has caused only minor procurement delays. However, of the three contracting officers (14%) answering "yes" to question C47, two believed that the Government failed to benefit from the delay. Despite this seemingly insignificant impact, procurement delays should be carefully monitored due to their counter-productive potential.

Some savings have resulted from the implementation of DoDD 7640.2 as Table XX points out. Information regarding the reported savings was not available. Therefore, the

TABLE XIX
Procurement Delays

C 47. Have you experienced any delay in procurement as a direct result of 7640.2?

CONTR

Yes	14%
No	86

C 48. Do you believe that the overall effect of this delay has been to the Government's advantage?

CONTR

Yes	33%
No	67

measure of government benefit cannot be accurately assessed. Most of the auditors indicated that direct savings cannot be determined. However they indicated that it is reasonable to assume that DoDD 7640.2 will produce savings by improving the negotiation process. It is rational to assume that improved negotiations will produce savings, but there was no evidence to support the belief that DoDD 7640.2 is achieving the necessary improvement in the negotiation process.

By passing Public Law 96-304, Congress required that audit findings be resolved within six months after a report is issued. Congress intended to support a similar provision found in Office of Management and Budget (OMB) Circular A-73, "Audit of Federal Operations and Programs." However, there appear to be some differences in opinion among practitioners and policy makers regarding the distinction between the resolution of audit recommendations and the disposition

TABLE XX
Direct Savings

A 38. In your organization, has there been any
C 49. documented recovery of public funds attributable
to the provisions of 7640.2?

	<u>CONTR</u>	<u>AUDIT</u>
Yes	0	12%
No	100%	88

of audit reports.⁷ Those differences center on the circumstances which constitute each of those actions.

The responses to question 21 (item a) of Table XXI show that 50% of all respondents believed that resolution of audit recommendations should not occur until negotiations with the contractor are concluded. Another 33% (response b) of all respondents agreed that resolution hinges on the decisions made by the contracting officer either before or during negotiations. Responses (e) and (f) show that only 14% of the respondents agreed with the official definition for resolution of audit recommendations given by DoDD 7640.2. In fact, responses (a), (b), and (c), which were cited by 96% of all respondents, form the respondents' definition of resolution. According to DoDD 7640.2, the situations described by responses (a), (b), and (c) constitute disposition. It seems that while DoDD 7640.2 emphasizes the timely resolution of differences between auditor and contracting officer, it nonetheless has achieved a "disposition" attitude in the minds of practitioners.

⁷See definitions, Appendix A

Audit recommendations may be expeditiously resolved through the provisions of DoDD 7640.2, however quick resolution between the auditor and contracting officer doesn't guarantee a timely disposition of the audit report. Table XII illustrates that DoDD 7640.2 has had no appreciable effect on the number of significant differences requiring resolution. Therefore, a rational assumption is that disposition of audit reports is the primary goal of the followup policy. The responses to question 8 of Table XI also support this assertion, since it was a popular belief that disposition of audit reports is needed to appease political critics.

Questions 22 and 23 of Table XXI evaluate the effect of DoDD 7640.2 on the speed of resolution. Most respondents (50%) indicated that there has been no effect from the directive in this area. However, 30% have experienced quicker resolution, while only 19% have experienced a slower process. As the data to question 23 show, quicker resolution has been unquestionably beneficial.

What is surprising is that of the three respondents who have experienced slower resolution, two have found the slower process to be beneficial. The most frequently given reason for this view was that the six month time requirement is not always in the government's best interests. Some audits, e.g. certain operations and overhead audits were cited as requiring more time to resolve significant issues. In those situations, pressuring for quick resolution can be detrimental. On the other hand, two contracting officers (9%) and one auditor (13%) have found detrimental effects from a slower resolution rate.

1. Beneficial Effects

Question 11 of Table XXII shows how each group felt about the benefits of the directive. Response (a), which

TABLE XXI
Benefit of Quicker Resolution

21. In your opinion, when is the proper time to consider audit recommendations as resolved?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
a. After negotiations when the contracting officer reaches agreement with the contractor ----	50%	50%	50%
b. When the contracting officer makes a decision either before or during negotiations -----	41	25	33
c. When the contractor corrects a deficiency or implements audit recommendations -----	9	25	13
d. Varies according audit type -----	14	0	10
e. When Auditor and Contracting Officer settle differences -----	9	0	7
f. When DISAO or Review Board approves of the Contracting Officer's position -----	5	13	7

22. As a result of the directive 7640.2, audit reports are resolved:

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Much quicker -----	0%	13%	3%
Somewhat quicker -----	23	38	27
No change -----	54	38	50
Somewhat slower -----	14	13	13
Much slower -----	9	0	6

23. In your view, has this change been of benefit to the Government?

	<u>CONTR</u>	<u>AUDIT</u>
<u>Much quicker</u>		
yes	0	100%
No	0	0
<u>Somewhat quicker</u>		
yes	80	100
No	20	0
<u>Somewhat slower</u>		
yes	67	0
No	33	100
<u>Much slower</u>		
yes	0	0
No	100	0

TABLE XXII
Benefits and Detriments

11. How do you think the goals of the directive are beneficial?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
a. Improved CO/auditor coordination leading to better problem visibility -----	27%	63%	37%
b. Management tool for contracting officers -----	36	13	30
c. Goals are admirable, but directive not needed. Goals stated elsewhere	23	13	20
d. No benefit -----	23	0	17
e. Improve timeliness of decision making -----	18	13	17
f. Potential cost savings -----	14	25	17
g. Increases CO accountability which produces better supported decisions	0	38	10
h. Better supported DCAA reports -----	5	13	7

12. How do you think the goals of the directive are not beneficial?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
a. More administrative burden, and bureaucratic growth potential ----	32%	13%	27%
b. No negative effects -----	14	63	27
c. Adverse effect on CO's authority and business judgment -----	27	13	23
d. A system to second-guess the CO --	27	0	20
e. More management time for questionable benefit since requirements already exist -----	14	13	13
f. Overemphasis on quick resolution -	14	0	10
g. Negative effect on CO/Auditor relationship -----	5	13	7

was the overwhelming preference of auditors, indicates that the directive has improved coordination between the auditor and the contracting officer, leading to better visibility of problems. While 27% of the contracting group also cited this as a benefit, slightly more (36%) viewed the procedures mandated by DoDD 7640.2 as a management tool for contracting officers. Only one auditor agreed with this view.

Response (g) shows that 38% of the auditors felt that the contracting officer's accountability had increased, with better supported decisions as a result. None of the contracting group said that an increase in accountability was a benefit of the directive, which illustrates the sensitivity of the contracting group to the question of accountability. That is understandable since the contracting officer is legally accountable for the contractual decisions he makes. To suggest that DoDD 7640.2 has affected the contractual accountability of the contracting officer would clearly be in error, and contrary to the explicit statement of the directive that "The contract audit followup system shall be in consonance with the independent decision-making role of the contracting officer." [Ref. 2: E-1]

Thirty-four percent of the respondents considered as benefits: (1) the improved timeliness of decision-making; and (2) the potential for cost savings to the Government (responses e and f). With respect to the timeliness of decision-making, one Air Force Principal Administrative contracting officer (PACO) made the following comment:

There is an unquestionable benefit which arises from the emphasis on timeliness. There has been a tendency on the part of many contracting officers to delay their decisions on tough problems. It seems that too often decisions on audit recommendations are postponed until there is an iron-clad case one way or the other. However, this is unrealistic. The contracting officer should be a decision-maker, and if he's doing his job correctly, many of the decisions will be tough ones. This policy will encourage the contracting officer who has a tendency to delay to speed up the decision-making process.

A DCAS Manager/ACO also expressed concern over the timeliness in which audit reports are settled.

The timeliness of resolution is important since economic issues change so rapidly in the dynamic economic environment of today. It's a good idea to avoid allowing these pricing issues to get old and turn into big problems. However, the professional contracting officer

should be resolving these issues without the policy being issued.

In contrast to the benefits attested to by the majority of comments to question 11, there were a significant number of less favorable comments, almost entirely from the contracting group. Responses (c) and (d) reveal that 46% of the contracting group (37% overall) either believed that the directive had no beneficial effects or that any benefits possibly arising from the policy are achievable through existing guidance or through the professional efforts of the work force.

2. Detrimental Effects

Response (b) to question 12 reveals again the support for DoDD 7640.2 within the auditing community. All audit responses other than item (b) were qualified in the sense that these non-benefits were believed not significant enough to question the overall benefit of the policy. One auditor stated that the directive can create ill feelings between the auditor and the contracting officer, but that in most cases the team concept will be encouraged. An audit manager commented:

Like most directives, the over-reaction by affected parties mitigate against its effectiveness. Too much paperwork and extensive management attention takes valuable time away from other equally important functions. However, the benefits far outweigh the drawbacks.

In sharp contrast to the audit group's response, only three of the twenty-two contracting respondents (14%) believed that there were no negative effects from the policy. Some of the contracting respondents were harsher than others in their criticism of the directive. One Price Analyst manager said that "the directive, as written,

suggests that the opinions of pricing analysts, engineers, and other advisers, are useless." Another contracting manager added that "audit followup isn't necessary if both organizations do the tasks laid out in miles of existing instructions, directives, and legislation."

VI. IMPACT ON CONTRACTING OFFICERS AND AUDITORS

A. AUTHORITY OF THE CONTRACTING OFFICER

The most publicized criticism of DoDD 7640.2 is its alleged adverse effect on the independent, decision-making authority of the contracting officer. The investigation of that claim provided the initial focus and the primary motivation for this research.

To fully appreciate the opinions of practitioners regarding the authority of the contracting officer, one must make a distinction between the different types of authority vested in the contracting officer.

The Defense Acquisition Regulation (DAR) contains details concerning the contracting officer's Certificate of Appointment, commonly referred to as a "warrant" [Ref. 6: 1-405.2]. It is the warrant which certifies that the contracting officer is an authorized agent of the Federal Government with the contractual authority to bind the government to legal agreements within specified limitations.

Expert advice is available to the contracting officer from a variety of functional specialists which he may call upon as necessary. However, the responsibility for determining the suitability of the pricing arrangement of a contract rests solely with the contracting officer [Ref. 6: 3-801.2].

Since DoDD 7640.2 is an internal directive not published in the Code of Federal Regulations, it cannot officially alter the contractual authority of the contracting officer which would in any way conflict with the provisions of the Defense Acquisition Regulation (DAR). Nevertheless, the data in Tables XXIII, XXIV, and XXV show that the directive

has impaired the administrative authority of the contracting officer, since he apparently has less control over other areas of the decision-making process.

The responses to question 16 of Table XXIII indicate that there was considerable difference of opinion between the contracting and auditing groups over that issue. While 55% of the contracting officers perceived that their authority has been weakened, only 25% of the auditors shared that opinion. Most (75%) of the audit group believed that the independent decision-making authority of the contracting officer has been unaffected by the directive, an opinion agreed upon by a relatively large portion (36%) of the contracting group. Only two of the contracting group (9%) believed that the contracting officer's authority has been strengthened by DODD 7640.2.

Responses (a) and (b) to question 17 show that the contracting officer's latitude in decision-making has been narrowed. However there was a wide range in the comments to that question. There were both advantages and disadvantages which emerged from the opposing perspectives. Among the contracting respondents, opinions were more negative in nature, since contracting officers were concerned about the potential for being "second-guessed." The requirement for more extensive justification for decisions was also viewed as a disadvantage. The following remarks by contracting officers and managers highlight the majority opinion of that group:

Contract audit is thought to be advisory. Accounting records represent historical cost data, they do not usually reflect technological changes which could affect the future. An informed contracting officer makes his decision based on all inputs, not just DCAA. This directive requires the contracting officer to elevate a disagreement to higher management who may not be familiar with the issue.

The impact from this directive is very important. The contracting officer is singularly responsible for all

TABLE XXIII
Authority of the CO

16. In your opinion, how has DoDD 7640.2 affected the independent, decision-making authority of the contracting officer?

	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
Weakened it -----	55%	25	47%
No effect -----	36	75	47
Strengthened it -----	9	--	6

17. Would you please explain your opinion including why you believe such an impact is or is not important.

<u>Weakened</u>	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>
a. CO must elevate significant audit issues which encourages less responsibility for decisions -----	36%	25%	33%
b. Auditor's power overemphasized --	27	0	20
c. CO frustration from administrative burden. Less time for other important tasks -----	5	0	3
<u>No effect</u>			
d. CO has same contractual authority, but less arbitrary ---	45%	50%	47%
e. Contracting officer still has the responsibility for contractual decisions -----	14	50	23
f. Only impact is administrative ---	14	0	10
g. Significant actions have always been reviewed by senior acquisition official -----	5	0	3
<u>Strengthened</u>			
h. Causes the CO to more carefully "think through" and document decisions -----	9%	0	6%

aspects of the award of a contract. The auditor is supposed to be a team member, no more, no less. This policy change makes the auditor much more powerful with no check or balance on the quality of the audit.

The hardest thing for a government bureaucrat to do consistently is act independently and forcefully. The system produces conformity and fosters the abdication of responsibility. Under the new followup system, weak contracting officers will become weaker, strong ones will be more frustrated. That's important.

Although 50% of the auditors believed that the directive makes the contracting officer less independent, their comments also indicated that the actions of contracting officers need closer scrutiny. The spirit of the audit group's comments can best be captured in this statement by an audit manager:

There is no change in the contracting officer's authority. He may still deviate from audit recommendations. However, now he must document, explain, and in some cases have an independent review of his decision. To the extent that his independent decision-making flexibility is constrained by the justification requirement, the directive could be viewed as beneficial.

It is interesting to note the opinions of two (9%) contracting officers who felt that DoDD 7640.2 has strengthened their authority. Although they recognize that the contracting officer is required to more thoroughly justify his decisions regarding audit recommendations, this requirement was considered an advantage. An Air Force PACO offers an explanation for this position:

Technically, there is no effect on the contracting officer's authority. However, the policy definitely puts the contracting officer on the spot regarding the decisions he makes on audit recommendations. If the contracting officer knows that he will have to defend his position to higher authority, this should cause him to think through a situation more carefully and therefore support his decision better. A contracting officer who does that will realize more authority, not because of the regulation saying he has more or less authority, but because he has done his homework.

B. ROLE OF THE DCAA AUDITOR

Contracting officers generally perceived that the DCAA auditor's role is changing from the traditional role of team member to one in which audit advice is virtually mandatory. In the current environment of cost control and fiscal

responsibility, DoDD 7640.2 has accorded audit advice preeminence over that received by the contracting officer from other functional advisers. That appears to be a difficult adjustment for most contracting officers who have perhaps viewed the auditor's role as subordinate to their own. The directive now requires justification to higher authority when the contracting officer decides to proceed upon a course of action which significantly differs from the auditor's recommendations. Many contracting officers and managers believed that the new audit followup procedures reflect declining confidence in the procurement work force.

It is interesting to note that the notion of elevating significant differences between the contracting officer and auditor is not a new idea. The Defense Contract Audit Advisory Council (DCAAC) recommended over a decade ago that those differences be elevated to ensure that a DoD position is agreed upon on a timely basis, thereby avoiding costly delays [Ref. 7]. However, until the DoD policy for contract audit followup was implemented, the only requirement for contracting officer deviations from audit advice was to document the contract file [Ref. 6:3-801.2(d)].

Shortly before the DCAAC's report, then Deputy Secretary of Defense David Packard issued a memorandum emphasizing the advisory role of the contract auditor. The memo also clarified the DoD position on elevating disputes between contracting officers and auditors:

I am concerned that there be a clear understanding of the advisory role the contract auditor has in support of the contracting officer. The independent, professional advice of auditors is essential to good Defense contracting. The contracting officer must consider such advice. Nevertheless, contracting officers' decisions on matters of contract pricing have to take into account many factors in addition to those presented by the auditors. It is, therefore, necessary that all those responsible for furnishing support to the contracting officer understand the advisory role they should play.

We should avoid actions by auditors in their advisory capacity which appear to dispute or question specific

decisions of contracting officers. I want our contracting people to exercise judgment in their day-to-day work. The escalation of possible disputes relative to specific decisions should be avoided. If, however, such decisions or judgment have general application and, in the professional opinion of the auditor, indicate a change or trend in pricing or costing policy, the auditors may, of course, transmit the appropriate information through audit command channels. [Ref. 8].

TABLE XXIV

Auditor's Influence on CO

18. In your opinion, how has the authority of the DCAA auditor been affected by directive 7640.2?				
	<u>CONTR</u>	<u>AUDIT</u>	<u>BOTH</u>	
a. Strengthened auditor's role or influence vis-a-vis the contracting officer -----	59%	50%	57%	
b. No effect on authority; auditor still has same advisory role and responsibilities -----	45	50	47	
c. Dislike term "authority" which implies that auditor has contractual authority -----	14	25	17	

Deputy Secretary Packard's memo illustrates well the traditional DoD philosophy regarding the advisory role, not only of auditors, but of all functional specialists who are available to counsel the contracting officer.

Response 18(a) of Table XXIV indicates that the provisions of DoDD 7640.2 have affected the auditor's influence on the contracting officer. The balanced responses to items (a) and (b) are an interesting finding, particularly when considering the comments related to auditors' authority. Those respondents who felt that the auditor's role has been strengthened spoke out at length while only brief comments were offered in support of the "no effect" opinions of

category (b). The following comments help to illustrate the opinions of those respondents who believed that the auditor's role has been enhanced:

An audit manager: Would rather not use the word "authority" in referring to the auditor's relationship with the contracting officer. However, the auditor's influence on the contracting officer has been strengthened.

An auditor: Now we have expanded duties to document a contracting officer's failure to have a DISAO review. We will probably also be somewhat involved in answering internal audit questions during reviews of compliance with the directive.

An Air Force manager: Technically, the auditor is still an adviser. However, the auditor has an avenue for recourse that other advisers don't have. This definitely has to have an effect, especially on those contracting officers who are perhaps less competent in the decision-making area. However, "authority" isn't quite the correct term.

A Navy PCO: Don't like the use of the word "authority" in connection with the auditor. That implies contractual authority which the auditor doesn't have. "Role" may be okay, but "influence" is an even better word. The auditor has been given much more power to influence the contracting officer.

A DCAS Manager/ACO: The audit position becomes more of a non-negotiable baseline which severely limits a contracting officer in negotiations.

A DCAS ACO: The auditor's star is rising. The contracting officer has been put on the defensive due to the auditor's appeal process.

C. RELATIONSHIPS

As the data in Table XXV indicates, auditors and contracting officers even failed to agree about the nature of their disagreements. Contracting officers said that they always explain their disagreements to the auditor (C 31) while the majority of the audit group (62%) said that contracting officers usually don't communicate their positions to the auditor.

TABLE XXV
CO-Auditor Relationship

- A 28. Prior to the advent of 7640.2, when a contracting officer disagreed with your recommendations, did he usually explain his position?

AUDIT

Yes	38%
No	62

- C 31. Before 7640.2, when you disagreed with the auditor's recommendations, did you usually explain your position to the auditor?

CONTR

Yes	100%
No	0

- C 32. Do you now generally resolve such disagreements with the auditor without going to a review official or board?

CONTR

Yes	68%
No	32

- A 29. Do you usually find it easy to establish good rapport with most contracting officers?

AUDIT

Yes	88%
No	12

- C 33. Have you been able to establish good rapport with most Contract auditors that you've dealt with?

CONTR

Yes	95%
No	5

The method which most contracting officers choose for communicating with the auditor undoubtedly has a lot to do with the dissenting viewpoints of the two groups. Most

(80%) of the contracting officers interviewed said that they rely almost entirely on the Price Negotiation Memorandum (PNM)^a to communicate their position to the auditor. The PNM is required by the Defense Acquisition Regulation (DAR) and serves the purpose of documenting:

1. The contracting officer's pre-negotiation position, including negotiation objectives and/or aspirations,
2. The major proceedings of the negotiation with the contractor, and
3. The results of the negotiation.

The majority opinion of contracting officers was that the PNM provides sufficient explanation to the auditor except for unusual cases where closer communication is necessary to resolve a significant issue and attain a united government position before proceeding into negotiations. Obviously, where the auditor participates in negotiations, there will be more informal communication with the contracting officer, particularly with regard to planning the negotiations.

The following comment (to question A28) by an audit manager helps to clarify the primary reason why auditors consider most contracting officers' explanations to be inadequate:

The key word here is "usually." Apparently some contracting officers do, others don't. Most contracting officers give some explanation of their use of audit findings in their Price Negotiation Memorandum, including justifications for their decisions. But the PNM isn't always received by DCAA. DoDD 7640.2 will require comprehensive justification in the PNM and also ensure that it is transmitted to the DCAA auditor.

The contracting officers' responses to questions C31 and C32 are interesting since they clearly show that the policy has affected the willingness of contracting officers to seek

^aSee definitions, Appendix A

resolution with the auditor. The six contracting officers (32%) who answered "no" to question C32 indicated that since the policy has been in effect, auditors seem more inflexible in their positions, and in the interest of time, they elevate their pre-negotiation differences for independent review. One Air Force manager attempted to put his finger on the issue:

Since the policy doesn't allow the auditor to change his mind, the contracting officer is going to pursue the course of action that is correct with respect to the inputs received from all his advisers. What reason is there for the contracting officer to discuss his position? Even if the auditor agrees with the contracting officer, he can't change his report. Reporting to DoD continues until negotiations are completed, a contractual agreement reached, or the report is otherwise disposed.

The data presented in response to questions A29 and C33 of Table XXV might lead one to conclude that there are inconsistencies in the responses of the two groups regarding the contracting officer/auditor relationship. However, a closer examination shows that the differing points of view are related only to the area of resolving differences of opinion on audit recommendations, not the overall relationship between the two parties. Most respondents acknowledged that a sound fundamental relationship between the contracting officer and auditor is necessary to execute contractual arrangements that are most advantageous to the government. A DCAS ACO expressed this opinion:

An interesting perception of Congress, GAO, DoD, and other top level officials is that DCAA auditors and DoD contracting officers are always in conflict or disagreement. I believe that while DCAA may have supported this policy in the beginning, there is less support for it now, at least in the field. I think many auditors realize that it is calling unnecessary attention to the contracting officer/auditor interface.

Although some respondents indicated that good rapport isn't always easy to achieve, they view it as a vital ingredient to an effective DoD procurement system.

1. Changes in Attitudes

Table XXVI (question A30) shows that auditors have encountered a wide range of effects from the directive on

TABLE XXVI
Changes in Attitudes

A 30. What changes if any have you noticed in the attitudes of contracting officers that could be linked to the implementation of this directive?

AUDIT

a. Contracting officers more willing to discuss positions with DCAA -----	63%
b. No change in attitude -----	25
c. Contracting officers more adversarial -----	25
d. Contracting officers dislike the directive ---	12

C 34. What changes if any have you noticed in the attitudes of auditors that could be linked to the implementation of this directive?

CONTR

a. No change in attitude -----	72%
b. Auditors less hesitant to ensure Contracting Officers comply with directive; more probing -	9
c. Auditors concerned that policy causes more rifts between them and contracting officers --	9
d. Auditors more concerned that audit is defensible -----	9

the attitudes of contracting officers. Response (a) indicates that most contracting officers (63%) have become more cooperative with the auditor. However, it is important to recognize that two (25%) of the auditors (responses c and d)

perceived contracting officers as more adversarial. That is attributable to a common perception among the contracting group that DCAA was highly influential in DoD's decision to institute the followup policy. In spite of that opinion, the responses to question C34 show that most of the contracting group (72%) have noticed no change in auditors' attitudes.

Although three of the audit group (37%) mentioned negative aspects of the policy (responses c and d to question A30), comments generally focused on the increase in cooperation which has resulted. Auditors felt that contracting officers have become more willing to coordinate their planned actions with the DCAA auditor. One audit manager cited a particular type of occurrence which the directive tends to discourage:

Contracting officers have always looked to auditors for concurrence in order to justify and support their decisions. Oftentimes I have had contracting officers ask me to change my report based on the contracting officer's discussions with the contractor. What usually happens is that the contracting officer will give the contractor a copy of the audit report, and the contractor in turn will direct his high-powered resources to refute the findings. The contractor will often convince the contracting officer that the auditor is being unreasonable and suggest that he attempt to get the auditor to agree with the contractor's position.

Two additional audit respondents agreed with the audit manager's point of view. They believed that DoDD 7640.2 will increase coordination between the auditor and contracting officer, giving the contracting officer both a better audit report and a fuller understanding of the pricing issues. They indicated that closer communication and cooperation between the contracting officer and auditor will reduce the tendency of contracting officers to accept a contractor's arguments without first consulting the auditor.

2. Effect on Contract Negotiations

Table XXVII addresses the impact from DoDD 7640.2 on the negotiation process. While 50% of the contracting group has experienced no effect from the directive's requirements, 45% felt that less effective negotiations have resulted. The issues raised by the contracting group with respect to the negotiation process merit repeating:

Air Force manager: It hasn't affected technique. However, it has required additional time, most of which is devoted to convincing the auditor that he should vacate positions not based on substantial evidence rather than allowing those issues to be elevated.

DCAS manager: This policy can cause delays and create internal problems on the government's negotiation team. The contracting officer's authority going into a negotiation is weaker since he is put on the defensive with respect to the government players (team members). It assumes the auditor is the standard. Audit is given more weight over other advisory sources.

Air Force manager: I am more conscious of audit recommendations, and invite the auditors to negotiations more frequently. However, the process has been slowed down. Calculations take longer, and preparing for the DISAO review takes more time away. These differences are more visible to the contractor and are to his advantage.

The remaining questions in Table XXVII have no direct relationship to the implementation of DoDD 7640.2. However, those questions were intended to reveal the attitudes of contracting officers regarding the participation of auditors in negotiations. Increased participation by auditors in the negotiation process is not an expressly stated goal of the directive. However, an audit manager expressed his view regarding the importance of this issue:

The auditor should definitely participate in more negotiations. This is a very political question internally (i.e. within DCAA). DCAA management feels that the auditors' participation in negotiations makes them better prepared to defend their findings. The auditor who participates in negotiations will be more prudent in deciding what is included in his audit report.

TABLE XXVII
Effect on Negotiations

C 27. How has the directive affected the way you negotiate?

CONTR

a. No effect -----	50%
b. Less effective negotiations due to divided government position -----	27
c. Less effective negotiations due to delays and less time for planning -----	23

C 28. What percentage of major negotiations in which you have participated also included the auditor as a participant?

CONTR

a. Respondents who said 100% -----	50%
b. Respondents who said 10 - 5% -----	18
c. Respondents who said none -----	18
d. Respondents who said 70 - 30% -----	14

A 26. How often have you participated in negotiations with contractors that you have audited?

CONTR

Occasionally -----	50%
Seldom -----	50

C 29. Did the auditor's participation generally prove to be helpful?

CONTR

Yes	83%
No	17

C 30. What is your opinion about auditors participating in negotiations with a contractor?

CONTR

a. A good idea only if auditor realizes that the contracting officer is the team leader -----	41%
b. Auditor's participation is generally helpful--	36
c. Auditor's participation is of some value depending on the situation -----	23
d. Auditor's participation is absolutely essential due to tactical importance as financial expert -----	18

A 27. Do you feel that auditors should participate in more negotiations?

AUDIT

Yes	100%
-----	------

Contracting officers have generally found auditors helpful in negotiations (C29) and unanimously agreed that auditors should participate, provided that the contracting officer has the authority to control the government's input to the process. The following two statements from the contracting group best convey the general feeling of the group regarding the auditor's participation in negotiations:

Navy ACO: I believe that a good auditor working as a team member is vital to effective negotiation. On the other hand, a weak auditor, or worse, a "treasure hunter," can disrupt negotiations and split the team. This is a condition which is understandably exploited by contractors.

DCAS manager: I think it's a good idea, definitely beneficial and productive, provided that the contracting officer retains ultimate authority to plan, conduct, and consummate the negotiations. The presence of the auditor gives the government team more options in its strategy with the contractor, but everyone should be aware of the need to present one and only one government position.

VII. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

A. SUMMARY

The primary purpose of this study was to investigate and report the effects of DoD's contract audit followup policy on the independent, decision-making authority of the contracting officer. The auditor's role in defense contracting and the relationship between the contracting officer and auditor were also examined. To determine the overall impact of the policy on the procurement process, numerous other areas related to contract auditing were explored.

The conclusions and recommendations that follow are based upon the perceptions of the participants of this study and the author's interpretation of those perceptions. References are made to selected literature sources where appropriate.

B. CONCLUSIONS

THE POLICY ATTRACTS UNNECESSARY ATTENTION TO THE RELATIONSHIP BETWEEN THE CONTRACTING OFFICER AND THE CONTRACT AUDITOR.

This study has shown that audit advice was used extensively by contracting officers prior to DoD's contract audit followup policy. The policy has not affected the number of significant differences of opinion between the contracting officer and auditor, nor has it affected the manner of achieving disposition of those audit reports containing significant recommendations. Likewise, the speed of resolving differences has essentially remained the same.

Close, effective communication between the contracting officer and auditor cannot be achieved through mandate. Were this possible, ideal relationships would currently exist between every contracting officer and auditor due to existing regulation [Ref. 6:3-801.5(b)(8)]. Likewise, forcing the resolution of disagreements where the will for reconciliation does not realistically exist is inadvisable, and cannot be expected to improve the fundamental relationship between the contracting officer and auditor.

A comparison of the professional competency of the two groups is instructive. The Defense Contract Audit Agency employs a highly professional staff of accountants and auditors, 95% of whom are college graduates and 20% Certified Public Accountants (CPAs) [Ref. 9]. In contrast, recent statistics published by the Federal Acquisition Institute show that the DoD contracting work force averages only 42% college graduates [Ref. 10]:

Because contract auditors on the average are more professionally competent than contracting officers, they gain authority from their special knowledge and expertise in the accounting, pricing, and costing areas. That is a well-acknowledged psychological phenomenon known as "expert power." The contracting officer is heavily dependent on the auditor for data that is essential to establishing sound pricing arrangements. The same is true for the contracting officer's other professional advisers. It is doubtful that a contracting officer would disagree with the recommendations of an auditor unless such a decision incorporated the overriding recommendations of other expert advisers. The contract audit followup policy mandated in DoDD 7640.2 has the effect of decreasing the effectiveness of the relationship between the contracting officer and auditor by artificially shifting their respective authority.

THE INDEPENDENT ROLE OF THE CONTRACTING OFFICER HAS BEEN ADVERSELY AFFECTED.

The contracting officer's freedom to disagree with the recommendations of advisers has been restricted by the requirements for: (1) extensive justification for decisions, (2) senior management review of position, (3) comprehensive reporting to higher authority, and (4) DCAA's right to appeal decisions.

The paramount goal of defense procurement should be to achieve an optimal contractual arrangement. Such an arrangement cannot be expected to incorporate the unanimous support and agreement from all of the contracting officer's advisers. The contracting officer is a manager of advisory resources. In this capacity, it is critical that he remain independent from excessive influence in any one area.

The directive provides no option for the auditor to withdraw a recommendation once an audit report is issued. The contracting officer must either accept the auditor's recommendations or assume the burden of explaining why the auditor is not correct. In addition, the auditor has the right to appeal the decision of the contracting officer where a pattern of disagreement is considered to exist, a recourse not available to other advisers. It is much less complicated for the contracting officer to agree with audit advice than to take issue with it.

Advisers communicate their input to the contracting officer prior to his reaching a decision. Since DoDD 7640.2 requires the "advice" of local management after the contracting officer has decided upon his position, the directive essentially casts local management as a second-guesser.

The management review should work as an information system for local management. Local management should have control over the review process, with the authority to

establish the appropriate procedures for conducting an independent review and to determine the circumstances that must exist before the review is required. That authority would permit local management to decide the most advantageous use of management and administrative resources.

Contracting officers can psychologically accept an adviser's authority that arises from his expertise and still maintain a healthy self-image as the team leader. However, as the findings of this study have shown, the self-confidence of the contracting work force has been inhibited by forced resolution, excessive reporting, and intensive management involvement.

THE DIRECTIVE HAS FAILED TO IMPROVE EFFECTIVE USE OF THE GOVERNMENT'S AUDIT RESOURCES.

There has been no appreciable effect on the resolution of significant differences of opinion between contracting officers and auditors. The time required to achieve resolution has essentially remained unchanged. The frequency with which significant differences occur has not changed, and all "independent" management reviews reported in this study have been decided in favor of the contracting officer. However, with the addition of the management review process, the potential exists for further delay in disposing of audit reports.

There is no evidence that the directive has saved the government money. However, most participants believed that comprehensive reporting through every level of management overburdens administrative resources and is counter-productive to the overall effectiveness of the procurement system.

THE DIRECTIVE IMPOSES ECONOMICALLY QUESTIONABLE GOALS ON DOD PROCUREMENT.

DoD's critics believe that the department as a whole has failed to fully utilize its audit resources. DoD's backlog of overaged contract audit reports has contributed significantly to creating an image of questionable integrity and prudence in its procurement system. That image has caused diminishing trust in the ability of the procurement work force to ensure that audit advice receives proper attention.

The participants of this study pointed to the political necessity of issuing DoDD 5000.42 and DoDD 7640.2. The audit followup policy requires intensive management of a politically sensitive area. However, there is no objective justification for concluding that there has been a favorable cost/benefit ratio achieved by more timely disposition of audit reports. On the other hand, there is evidence that DoD's backlog of overaged contract audit reports fails to support the notion that DoD contractors are receiving excessive profits. Defense contractors are less profitable than their commercial counterparts, a situation that has made the defense industry less attractive to prospective contractors [Ref. 11]. If defense contractors were excessively profitable, the industry would be expanding rather than dwindling.

C. RECOMMENDATIONS

CONGRESS SHOULD EXEMPT CONTRACT AUDIT REPORTS FROM THE LEGAL REQUIREMENT FOR RESOLUTION.

That action would enable DoD to cancel DoDD 7640.2.

DOD SHOULD CANCEL DODD 7640.2.

The followup of contract audit reports is a valid concept. However, local management should be given the authority to establish the followup procedures that it

considers appropriate. Management should then be made responsible for ensuring that procurement and audit resources are used most effectively and efficiently.

IF THE FIRST TWO RECOMMENDATIONS ARE NOT FEASIBLE, DOD SHOULD REVISE DODD 7640.2 AS FOLLOWS:

1. Delete all status reports not specifically required by higher authority. Semi-annual reports that are required should be initiated by DCAA. Close communication with contracting officers will ensure that only overaged audit reports are reported to top management.
2. Eliminate the requirement for mandatory senior management review of unresolved audit recommendations. Local management should have the discretion to establish the procedures that are considered necessary to identify and resolve significant audit issues.

D. CONSIDERATIONS FOR FUTURE RESEARCH

The Defense Manpower Data Center is currently conducting a nationwide survey of the effects of DoDD 7640.2 on defense procurement. The results of that study should be considered in any decision regarding further research into the policy for followup of contract audit reports.

APPENDIX A
KEY DEFINITIONS AND ACRONYMS

Contract Audit: The systematic examination of records and documents and/or the securing of other evidence by confirmation, physical inspection, or otherwise, for one or more of the following purposes: (1) determining the propriety or legality of proposed or consummated transactions; (2) ascertaining whether all transactions have been recorded and are reflected accurately in accounts; (3) determining the existence of recorded assets and inclusiveness of recorded liabilities; (4) determining the accuracy of financial or statistical statements or reports and the fairness of the facts they present; (5) determining the degree of compliance with established policies and procedures relative to financial transactions and business management; and (6) appraising an accounting system and making recommendations concerning it.

Contract Auditor: A professional accountant acting as a principal advisor to contracting officers on contractor accounting and contract audit matters.

Contract Audit Report: The contract auditor's written advice to a contracting officer advocating specific action on the part of the contracting officer or contractor. An audit report could include amounts questioned or disapproved, exceptions to a contractor's system or operations, usually expressed in terms of cost avoidance, or notification of a contractor's non-compliance with Cost Accounting Standards (CAS). Any cost set aside as "unsupported" or "unresolved" will not be considered as a recommendation.

Contracting Officer: Any person who, either by virtue of his/her position or by appointment in accordance with prescribed regulations, is vested with the authority to enter into and administer contracts and make determinations and findings with respect thereto, or with any part of such authority. In this thesis, two kinds of contracting officers are identified: Procuring Contracting Officer (PCO), and Administrative Contracting Officer (ACO).

Cost or Pricing Data: Data consisting of all facts existing up to the time of agreement on price, which prudent buyers and sellers would reasonably expect to have a significant effect on price negotiations. Being factual, these data are types of information that can be verified. They do not reflect on the accuracy of the contractor's judgment about estimated future costs or projections; they do, however, reflect on the data upon which the contractor based his judgment.

Costs Questioned Sustained: That portion of costs questioned by the auditor that is upheld as a result of actions taken either by the contractor or the contracting officer.

Disposition of Contract Audit Reports: Contract audit report disposition is achieved when: (1) the contractor implements the audit recommendations; or (2) the contracting officer negotiates a settlement with the contractor; or (3) the contracting officer makes a unilateral decision; or (4) a decision has been rendered on an appeal made to the Armed Services Board of Contract Appeals (ASBCA) or U.S. Claims Court; and (5) all corrective actions deemed necessary by the contracting officer have been taken and no further actions can be reasonably anticipated.

Overaged Audit Report: An audit report which remains open over six months from the date of issuance.

Price Negotiation Memorandum: The document that relates the story of the negotiation. It is first a sales document that establishes the reasonableness of the agreement reached with the successful offeror. Second, it is the permanent record of the decisions of the negotiator made in establishing that the price was fair and reasonable. Called the PNM.

Resolution: The point at which the audit organization and the contracting officer agree on the action to be taken on audit report recommendations; or, in the event of disagreement, when the matters are elevated for review by the DISAO and its recommendations have been considered by the contracting officer and he or she has selected a course of action.

ACO	Administrative Contracting Officer
CO	Contracting Officer
COIN	Contracting Officer's Information Network
DCAA	Defense Contract Audit Agency
DCAS	Defense Contract Administration Services
DISAO	Designated Independent Senior Acquisition Official
DLA	Defense Logistics Agency
DoD	Department of Defense
DoDD	Department of Defense Directive
FAI	Federal Acquisition Institute
GAO	General Accounting Office
OFPP	Office of Federal Procurement Policy
OMB	Office of Management and Budget
PCO	Procuring Contracting Officer
PNM	Price Negotiation Memorandum

APPENDIX B
DOD DIRECTIVE 7640.2



December 29, 1982
NUMBER 7640.2

Department of Defense Directive

IG, DoD

SUBJECT: Policy for Followup on Contract Audit Reports

- References:**
- (a) DoD Directive 5000.42, "Policy for Follow-up on Audit Recommendations," August 31, 1981 (hereby canceled)
 - (b) Office of Management and Budget (OMB) Circular A-50 (Revised), "Audit Followup," September 29, 1982
 - (c) DoD Directive 5000.41, "Followup on Reports from the General Accounting Office and Audit and Internal Review Organizations of the Department of Defense," March 15, 1982
 - (d) through (h), see enclosure 1

A. PURPOSE

This Directive reissues reference (a), implements reference (b) by prescribing followup policies and a system for management action on contract audit reports, and assigns responsibilities.

B. APPLICABILITY

This Directive applies to the Office of the Secretary of Defense, the Military Departments, the Organization of the Joint Chiefs of Staff, and the Defense Agencies (hereafter referred to as "DoD Components").

C. POLICY

The Department of Defense recognizes, under reference (c), the need for special guidance for followup on contract audit reports to accommodate the differences between such audits or reviews and those performed by internal auditors. The contract audit followup system provides for (a) tracking and reporting specified types of contract audit reports; (b) a procedure to review differences on the resolution of contract audit recommendations; and (c) an evaluation of the effectiveness of the DoD Components' followup systems.

D. DEFINITIONS

Terms used in this Directive are defined in enclosure 2.

E. PROCEDURES

1. General. Contracting officers and acquisition management officials shall pursue timely resolution and disposition of contract audit reports. Resolution of contract audit reports by law is required within 6 months of report issuance, and disposition normally shall be completed within 6 months. The contract audit followup system shall be structured in consonance with the independent decisionmaking role of the contracting officer and the financial advisory role of the contract auditor.

2. Tracking Requirements

a. All contract audit reports are to be tracked; however, only the contract audits specified in paragraph E.3.a., below, are to be reported. For preaward contract audits, tracking may be accomplished using records maintained in official contract files.

b. Individual procurement or contract administration offices shall track the status of all specified contract audit reports from the date of receipt through final disposition. This information shall be maintained on a current basis and shall serve as the source document for followup status reports. Audit reports may be dropped from the tracking system in the period following closing.

3. Reporting Requirements

a. Audit reports covering forward pricing proposals, advance rate agreements, progress payments, and closing statements are not required to be reported. DoD acquisition and contract administration organizations shall maintain timely and complete information regarding the status of reportable contract audit reports from the time the report is received through final disposition. Reportable audit reports are:

(1) Those containing recommendations covering estimating system surveys, accounting system reviews, internal control reviews, defective pricing reviews, cost accounting standards noncompliance determinations, and operations audits.

(2) Those covering incurred costs, settlement of indirect cost rates, final pricing submissions, termination settlement proposals, equitable adjustment claims, hardship claims, and escalation claims provided reported costs or rates questioned equal \$50,000 or more.

b. The information maintained by DoD Components regarding the status of reportable contract audits shall be reported semiannually and include the following data:

(1) For reports closed during the reporting period. The audit report number, report date, contractor name, type of audit, date of disposition, costs questioned or cost avoidance, and costs questioned or avoidance sustained.

(2) For open reports. The audit report number, report date, contractor name, type of audit, amount audited, costs questioned or cost avoidance, whether an independent review was requested, whether the report is pending litigation, whether the report is resolved or unresolved, and disposition target date.

(3) Followup status reports (enclosure 3) for semiannual periods ending March 31 and September 30 shall be submitted to the Inspector General, DoD, (IG), within 30 calendar days after the end of the period.

4. Resolution of Contract Audit Report Recommendations

a. From the time of audit report receipt to the time of final disposition of the audit report, there shall be continuous communication between the auditor and the contracting officer. When the contracting officer's proposed disposition of contract audit report recommendations differs from the contract auditor's report recommendations, and the criteria set forth below are met, the contracting officer's proposed disposition shall be brought promptly to the attention of a designated independent senior acquisition official or board (DISAO) for review. Each DoD acquisition component shall designate a DISAO at each appropriate organizational level who shall review the referred proposed disposition on the following:

(1) All audit reports covering estimating system surveys, accounting system reviews, internal control reviews, defective pricing reviews, cost accounting standards noncompliance reviews, and operations audits.

(2) Audit reports covering incurred costs, settlement of indirect cost rates, final pricings, terminations, equitable adjustment claims, hardship claims, and escalation claims if total costs questioned equal \$50,000 or more and differences between the contracting officer and auditor total at least 5 percent of questioned costs.

(3) Prenegotiation objectives for forward pricing actions when questioned costs total at least \$500,000 and unresolved differences between the auditor and contracting officer total at least 5 percent of the total questioned costs.

b. Existing acquisition review boards or panels, at appropriate organizational levels, may be designated to perform these functions provided they possess enough independence to conduct an impartial review. The DISAO will receive for review, along with other technical materials, the contract auditor's report. The DISAO shall give careful consideration to recommendations of the auditors, as well as the recommendations rendered by the other members of the contracting officer's team, in reviewing the position of the contracting officer. The DISAO shall provide to the contracting officer, with a copy to the contract auditor, a clear, written recommendation concerning all matters subject to review.

5. Notification of Final Disposition of Contract Audit Report

a. Any followup system requires adequate feedback to the auditor on the final disposition of audit reports. Therefore, the contracting officer shall prepare a memorandum covering the disposition of all audit reports. The

memorandum shall discuss the disposition of all audit report recommendations, including the underlying rationale for such dispositions. In the event a DISAO review was obtained, the memorandum also shall discuss the disposition of the DISAO recommendations. A copy of the memorandum shall be provided to the cognizant contract auditor and to the DISAO.

b. Existing feedback reports such as a price negotiation memorandum (DAR 3-811(a), reference (d)) or a written overhead negotiation memorandum (DAR 3-705(b)(5), reference (d)) may be used, when applicable. For all other actions a similar document shall be prepared. To ensure that the final disposition of all audit reports is properly accounted for, each DoD Component's procurement or administrative contracting officer shall notify the cognizant audit office in writing of cancellations of any acquisition action and of any unsuccessful offerors not receiving award of a contract or grant for which an audit report was issued.

6. Recovery of Funds. Policies regarding the DoD credit management and debt collection program are contained in DoD Directive 7045.13 (reference (e)) and in Appendix E of the DAR (reference (d)) for contract debts. Paragraph E.4.f. of DoD Directive 5000.41 (reference (c)) requires the establishment of an account receivable when management agrees with the auditors that resources shall be recovered. General ledger accounts for recording accounts receivable and collections are detailed in Appendix B of DoD 7220.9-H (reference (f)).

7. Coordination with Other Agencies. The cognizant contracting office responsible for acting on contract audit reports that affect contracts of other government agencies shall inform affected organizations of such actions.

F. RESPONSIBILITIES

1. The Secretaries of the Military Departments and the Directors of the Defense Agencies shall:

a. Designate a senior management official (SMO) to serve as a focal point for the audit followup function. The SMO shall be responsible for establishing the DoD Component's followup procedures for contract audits and for the system's overall operation, tracking, and reporting requirements.

b. Designate DISAOs within their DoD Components' procurement and contract administration functions who shall review those cases where the contracting officer's proposed disposition of contract audit report recommendations differs from the contract auditor's report recommendations.

c. Ensure that periodic evaluations of their Components' followup systems are performed to determine that the systems are adequate and result in timely and appropriate resolution and disposition of audit reports. The Military Departments shall have their internal audit organizations perform these reviews. The Assistant Inspector General for Auditing shall review the Defense Agencies' followup systems.

2. The Inspector General, DoD, shall develop policy and monitor and coordinate contract audit followup systems in the Department of Defense. In discharging this responsibility, the IG shall:

a. Develop policy and provide guidance to DoD Components on matters covered under this Directive.

b. Monitor and evaluate program performance and the adherence of DoD Components to contract audit followup policies and procedures.

c. Conduct oversight reviews that are determined necessary to ensure that DoD Components concerned are evaluating effectively contract audit followup systems.

d. Identify cases or areas where contract audit followup procedures can be improved and recommend appropriate corrective action to the DoD Component head concerned.

e. Obtain such reports consistent with the policies of DoD Directive 5000.19 (reference (g)) and conduct oversight reviews necessary to ensure that DoD followup systems are timely and effective.

f. Provide reports to the Secretary of Defense, including those required by OMB Circular A-50 (reference (b)).

3. The Senior Management Official (SMO) for each DoD Component shall:

a. Establish procedures for maintenance of formal records on all applicable contract audit reports covered in section D., enclosure 4.

b. Establish procedures to monitor the timely resolution and disposition of contract audit reports.

c. Maintain consolidated records of the status of all reportable contract audit reports.

d. Prepare the DoD Component's semiannual status report and submit it to the IG in accordance with the procedures in subsection E.3., above, and enclosure 3 of this Directive.

4. The DoD Components' Designated Independent Senior Acquisition Officials or Boards (DISAOs) shall have enough independence to conduct an impartial review of issues brought before them and shall:

a. Review the contracting officer's proposed disposition of contract audit recommendations when the contracting officer proposes to resolve the issue in a manner substantially different from the contract auditor's reported recommendation (see subsection E.4., above). Such reviews shall be initiated by the cognizant contracting officer whose prenegotiation objective or proposed disposition of a contract audit report shall be forwarded for review to the DISAOs. The DISAOs may request that the auditor or contracting officer provide additional input. The DISAOs shall review the issues being referred, make a specific written recommendation to the contracting officer, and provide a copy of the recommendation to the contract auditor concerned.

b. Identify needs for additional or revised guidance or changes in policy or regulatory requirements and forward details to the DoD Component concerned with suggestions for the change or additional guidance needed.

5. Managers of Individual DoD Procurement Contract Administration Offices shall ensure that appropriate action is taken to:

- a. Resolve promptly all contract audit reports in accordance with acquisition guidelines and the requirements of this Directive.
- b. Track the status of actions on all contract audit reports from the date of receipt through disposition.
- c. Establish and monitor procedures to ensure the forwarding of required information to the DISAO responsible for reviewing differences of opinion on contract audit reports.
- d. Maintain and provide information required in section E., above.

6. Heads of the Cognizant DoD Internal Audit Organizations shall:

- a. Be responsible for internal reviews to determine if the DoD Components' followup systems are adequate and result in timely and appropriate resolution and disposition of audit reports.
- b. Complete the first evaluation of the system within 1 year of the system's implementation and perform evaluations not less than every 2 years thereafter.

7. The Director, Defense Contract Audit Agency (DCAA), and Heads of Other Contract Audit Organizations shall:

- a. Provide timely and complete support to any DISAO's request for factual information or audit opinions regarding the audit reports under review.

b. Monitor all final disposition and negotiation memoranda received. When the memoranda indicate that a pattern of substantial differences of opinion exists on the disposition of contract audit reports, whether the contracting officer did or did not request reviews by the DISAO, the contract audit field office auditor shall refer the matter to the cognizant DCAA regional director. The regional director shall review these cases with the cognizant SMO. When a memorandum indicates that there is a substantial difference of opinion on the disposition of an audit report, and the contracting officer did not request a review by the DISAO, the auditor shall provide written notification of the observation to the contracting officer requesting that similar differences be elevated for review in the future and maintain a copy of all notifications to be available to the IG and internal auditors, upon request.

- c. Provide timely and complete support to the IG and any internal audit organization reviewing a DoD Component's contract audit followup system, in accordance with DoD Instruction 7600.3 (reference (h)).

d. Identify for the DoD procurement or administrative component, at the time of issuance, all contract audit reports reportable under subsection E.3., above, and provide a record of such reports to the DoD Components at least semiannually.

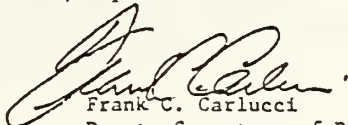
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G. INFORMATION REQUIREMENTS

The reporting requirements of this Directive have been assigned Report Control Symbol DD-R&O(SA)1580.

H. EFFECTIVE DATE AND IMPLEMENTATION

This Directive is effective immediately. Forward one copy of implementing documents to the Inspector General, Department of Defense, within 120 days.


Frank C. Carlucci
Deputy Secretary of Defense

Enclosures - 4

1. References
2. Definitions
3. Followup Status Reports
4. Contract Audit Reports Subject to Tracking, Reporting, Resolution, and Notification Requirements

REFERENCES, continued

- (d) Defense Acquisition Regulations (DAR)
- (e) DoD Directive 7045.13, "DoD Credit Management and Debt Collection Program," July 8, 1982
- (f) DoD 7220.9-H, "Accounting Guidance Handbook," February 1, 1978, authorized by DoD Instruction 7220.9, October 22, 1981
- (g) DoD Directive 5000.19, "Policies for the Management and Control of Information Requirements," March 12, 1976
- (h) DoD Instruction 7600.3, "Internal Audit in the Department of Defense," January 4, 1974

Dec 29, 82
764Q.2 (Encl 2)

DEFINITIONS

- A. Closed Audit Report. An audit report that has been dispositioned.
- B. Contract Audit Report. The contract auditor's written advice to a contracting officer advocating specific action on the part of the contracting officer or contractor. An audit report could include amounts questioned or disapproved, exceptions to a contractor's system or operations, usually expressed in terms of cost avoidance, or notification of a contractor's non-compliance with cost accounting standards. Any cost set aside as "unsupported" or "unresolved" will not be considered as a recommendation.
- C. Costs Questioned Sustained. That portion of costs questioned by the auditor that is upheld as a result of actions taken by either the contractor or the contracting officer.
- D. Disposition of Contract Audit Reports. Contract audit report disposition is achieved when (1) the contractor implements the audit recommendations; or (2) the contracting officer negotiates a settlement with the contractor; or (3) the contracting officer makes a unilateral decision; or (4) a decision has been rendered on an appeal made to the Armed Services Board of Contract Appeals (ASBCA) or U.S. Claims Court; and (5) all corrective actions deemed necessary by the contracting officer have been taken and no further actions can be reasonably anticipated.
- E. Litigation. An audit report is in litigation any time an appeal has been filed with the ASBCA or any court concerning an audit recommendation.
- F. Open Audit Report. An audit report that has not been dispositioned.
- G. Overaged. An audit report that has not been dispositioned and is over 6 months old (from date of issuance) on the "as of" date of the status report.
- H. Resolution. The point at which the audit organization and the contracting officer agree on the action to be taken on audit report recommendations; or, in the event of disagreement, when the matters are elevated for review by the DISAO and its recommendations have been considered by the contracting officer and he or she has selected a course of action.

Dec 29, 82
7640.2 (Encl 3)

FOLLOWUP STATUS REPORTS
RCS DD-R&O(SA)1580

A. The reports shall provide the information detailed in paragraph E.3.b., basic Directive. All listed reports shall be tracked and reported through final disposition.

B. Each acquisition and contract administration senior management official shall submit a semiannual status report in the attached format. Summary reports for DoD Components shall be submitted to the IG. The reports shall cover the semiannual periods ending March 31 and September 30 and shall be submitted within 30 calendar days after the end of the period. Items shall be removed from the tracking and reporting system in the period following that in which they appeared on the status report as being closed. The first semi-annual report shall cover the period ending September 30, 1983.

Attachments - 2

1. Status Report on Specified Contract Audit Reports--Open Reports
2. Status Report on Specified Contract Audit Reports--Reports Closed
During Period

STATUS REPORT ON SPECIFIED CONTRACT AUDIT REPORTS
(Report Control Symbol DD-R60(SA)1560)

OPEN REPORTS

For period ending _____
DoD Component _____

Audit Report Number	Report Date	Contractor Name	Type of Audit	Amount Audited	Cost Questioned or Cost Avoidance	Was Independent Review Requested ²	Open Pending Litigation ²	Resolved or Unresolved	Disposition Target Date

A. Overaged Reports

1. Overaged in prior report
2. Overaged as of this report

B. Reports less than
6 months old

¹Year, month, day
²Yes (Y), no (N), or not applicable (NA)

STATUS REPORT ON SPECIFIED CONTRACT AUDIT REPORTS
Report Control Symbol DD-R&O(SA)1380

REPORTS CLOSED DURING PERIOD

For period ending _____
DoD Component _____

Audit Report Number	Report Date	Contractor Name	Type of Audit	Date of Disposition	Costs	
					Questioned or Cost Avoidance	Costs Sustained

- A. Reports listed as
overaged in prior
report
- B. Other reports closed
during period

¹Year, month, day

Dec 29, 82
7640,2 (Encl 4)

CONTRACT AUDIT REPORTS SUBJECT TO TRACKING,
REPORTING, RESOLUTION, AND NOTIFICATION REQUIREMENTS

A. Reports Subject to Tracking

All contract audit reports (for preaward contract audits, tracking may be accomplished using records maintained in official contract files).

B. Reports Subject to Tracking and Reporting Requirements of Subsections E.2. and E.3., Basic Directive:

1. All reports with audit recommendations:
 - a. Estimating system surveys
 - b. Accounting system reviews
 - c. Internal control reviews
 - d. Defective pricing reviews
 - e. Cost accounting standards noncompliance reviews
 - f. Operations audits
2. Reports with recommendations and costs questioned of \$50,000 or more:
 - a. Incurred costs
 - b. Settlement of indirect cost rates
 - c. Final pricing submissions
 - d. Termination settlement proposals
 - e. Equitable adjustment claims
 - f. Hardship claims
 - g. Escalation claims

C. Reports Subject to Resolution of Differences

All contract audit reports.

D. Reports Subject to Resolution and Notification Requirements of Subsections E.4. and E.5., Basic Directive:

1. All reports with audit recommendations:
 - a. Estimating system surveys
 - b. Accounting system reviews
 - c. Internal control reviews
 - d. Defective pricing reviews
 - e. Cost accounting standards noncompliance reviews
 - f. Operations audits
2. Reports with recommendations and costs questioned of \$50,000 or more and with unresolved differences between the auditor and contracting officer that total at least 5 percent of total costs questioned:

- a. Incurred costs
- b. Settlement of indirect cost rates
- c. Final pricing submissions
- d. Termination settlement proposals
- e. Equitable adjustment claims
- f. Hardship claims
- g. Escalation claims

3. Reports with recommendations on proposals and costs questioned of \$500,000 or more or on rate proposals with a pricing impact equal to at least \$500,000 and with unresolved differences between the auditor and contracting officer that total at least 5 percent of total costs questioned:

- a. Forward pricing
- b. Advance rate agreements

APPENDIX C
DOD DIRECTIVE 5000.42



August 31, 1981
NUMBER 5000.42

Department of Defense Directive

ATSD(R&O)

SUBJECT: Policy for Follow-up on Contract Audit Recommendations

Reference: (a) DoD Directive 5000.41, "Policies for Follow-up on Audit and Internal Review Reports," January 16, 1981
(b) OMB Circular A-73, "Audit of Federal Operations and Programs"
(c) Defense Acquisition Regulations (DAR)
(d) DoD 7220.9-H, "Accounting Guidance Handbook," February 1, 1978, authorized by DoD Instruction 7220.9, "Guidance for Accounting and Reporting for Appropriations and Related Programs and Budgets," July 12, 1971

A. PURPOSE

1. This Directive prescribes follow-up policies for management action on contract audit recommendations made by the Defense Contract Audit Agency (DCAA). The DoD general policy on audit follow-up, contained in reference (a), recognized the need for special guidance for follow-up on contract audit recommendations to accommodate the differences between such audits and audits or reviews performed by internal auditors. This Directive provides that guidance.

2. This Directive implements reference (b) by establishing a system for follow-up on contract audit recommendations. The system provides for (a) tracking and reporting significant contract audit reports and recommendations; (b) a procedure to resolve differences on the disposition of significant contract audit recommendations; and (c) an evaluation of the effectiveness of the DoD Components' follow-up systems.

B. APPLICABILITY

The provisions in this Directive apply to the Office of the Secretary of Defense, the Military Departments, the Organization of the Joint Chiefs of Staff, and the Defense Agencies (herein referred to as "DoD Components"). The term "Military Services," as used herein, refers to the Army, Navy, Air Force, and Marine Corps.

C. DEFINITIONS

Terms used in this Directive are defined in enclosure 1.

D. POLICY

1. General. Contracting officers and other acquisition management officials shall pursue timely resolution of contract audit recommendations. The contract audit follow-up system shall be structured in consonance with the independent decision-making role of the contracting officer and the financial advisory role of the contract auditor.

2. Tracking and Reporting Requirements on Contract Audit Recommendations. DoD acquisition organizations will track and report on all significant contract audit recommendations involving actions such as incurred costs, settlement of indirect cost rates, termination settlement proposals, claims proposals, progress payment requests, final pricing or closing of a contract, estimating systems surveys, accounting system and internal control reviews, defective pricings, noncompliance with cost accountings standards, operations audits and contract modifications. Status reports shall be prepared for all tracked recommendations that remain open for more than 6 months after the audit report date. Except for estimating system surveys, other audit recommendations involving original placement of contracts will not be included in the status report or the tracking system required by this Directive.

3. Management Oversight of the Disposition of Contract Audit Recommendations. DoD policy requires resolution of differences between the contracting officer and the contract auditor on settlement of all significant contract audit recommendations.

a. Each DoD Component shall designate an independent senior acquisition official at each appropriate organizational level who will review any such differences before final settlement. Each DoD Component shall also designate an independent senior acquisition official to review the contracting officer's prenegotiation objective in connection with all negotiated contract actions where the pricing proposal is at least \$500,000 and significant audit recommendations have not been resolved by agreement between the auditor and the contracting officer.

b. Existing acquisition review boards or panels, at appropriate organizational levels, may be designated to perform both functions. The official will receive for review, along with other technical materials, the contract auditor's report. The official shall give careful consideration to all significant recommendations of the auditors, as well as the recommendations rendered by the other members of the contracting officer's team, in evaluating the negotiating objectives proposed by the contracting officer. The official shall provide a written report to the contracting officer, and shall take a clear position on all significant differences.

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4. Early Resolution of Differences of Opinion on Contract Audit Recommendations. From the time of audit report issuance to the time of final resolution of the audit recommendations, there shall be continuous communication between the auditor and the contracting officer. Differences of opinion on the proposed disposition of significant audit recommendations shall be brought promptly to the attention of the designated official, review board, or panel for early review.

5. Notification of Final Disposition of Contract Audit Report. Any follow-up system requires adequate feedback to the auditor on the final disposition of audit recommendations. Therefore, the contracting officer shall prepare a memorandum covering the disposition of all audit report recommendations, and the underlying rationale for such disposition. A copy will be provided to the cognizant contract auditor and the independent senior acquisition official or board. All such memoranda shall specifically state whether or not the contracting officer requested a review and shall explicitly delineate every instance in which the contracting officer has taken an action different from that recommended by the independent senior acquisition official. Existing reports such as a price negotiation memorandum (DAR 3-811(a), reference (c)) or a written overhead negotiation memorandum (DAR 3-705(b)(5), reference (c)) may be used, when applicable. For all other actions a similar document should be prepared. To ensure that the disposition of all audit reports is properly accounted for, each DoD Component must notify the cognizant audit office in writing of cancellations of any acquisition action and of any unsuccessful offerors not receiving award of a contract or grant for which an audit report was issued.

6. Recovery of Funds. DoD Components shall initiate prompt action to collect contract debts. Policies and procedures governing the collection of contract debts are contained in Appendix E of the DAR (reference (c)). Policies and procedures to account for contract debts are contained in DoD 7220.9-H (reference (d)), and in subsection D.6., DoD Directive 5000.41, (reference (a)), regarding the establishment of accounts receivable when management agrees with the auditors that resources should be recovered.

7. Coordination with Other Agencies. The cognizant contracting office responsible for acting on contract audit recommendations that affect contracts of other government organizations will have procedures to inform affected organizations of such actions.

E. RESPONSIBILITIES

1. The Secretaries of the Military Departments and the Directors of the Defense Agencies shall:

a. Designate a senior management official to serve as a focal point for the audit follow-up function. The designated official shall be responsible for establishing the DoD Component's follow-up procedures for contract audits, and for the system's overall operation and reporting requirements.

b. Designate independent senior acquisition officials, boards, or panels within the DoD Component's procurement and contract administration functions who shall review those cases where the contracting officer's proposed disposition of significant contract audit recommendations differs substantially from the contract auditor's report recommendations. These officials, boards, or panels shall have sufficient independence to conduct an impartial review of the issues brought before them, and in accordance with procedures in subsection D.3. of this Directive, shall provide to the contracting officer objective written reports on the issues involved.

c. Ensure that periodic evaluations of DoD Component follow-up systems are performed to determine that the system is adequate and results in timely and appropriate disposition of the audit recommendations. The Military Departments will have their internal audit agencies perform these reviews. The Defense Audit Service will review the Defense Agencies' follow-up systems.

2. The Follow-up Focal Point for each DoD Component shall:

a. Establish procedures for the maintenance of formal records on all applicable contract audit reports issued by the DCAA covered in the procedures in enclosure 2.

b. Establish procedures to monitor the disposition of contract audit recommendations to ensure that appropriate actions are initiated and completed.

c. Prepare the DoD Component's semiannual status report and submit it to the Office of the Assistant to the Secretary of Defense (Review and Oversight) (OATSD(R&O)) in accordance with the procedures in section F. of this Directive.

3. The DoD Components' Designated Independent Senior Acquisition Official or Boards shall establish procedures for resolving disagreements on the action taken on all significant contract audit recommendations. These procedures shall comply with the following criteria:

a. The designated independent senior acquisition official or board shall review the contracting officer's proposed disposition of every significant contract audit recommendation when that contracting officer intends to resolve the issue in a manner substantially different from the contract auditor's reported recommendation.

b. Such reviews shall be initiated by the cognizant contracting officer. The contracting officer's written statement on a proposed disposition of the significant audit recommendation shall be forwarded for review to the designated official or board. The reviewing official or board may request that DCAA provide additional input. The reviewing official or board shall make a specific recommendation on each audit finding received, and provide a written statement of the recommendation to the contracting officer and the contract auditor involved.

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c. The reviewing official or board shall also consider disagreements when the review is requested by the DCAA. Such requests would occur in cases where the negotiation memorandum indicates that there is a substantial difference of opinion on the settlement of a significant audit recommendation, and the contracting officer did not request a review by the designated official or board. The reviewing official or board shall obtain from the contracting officer the reasons for not complying with the provisions of subsections D.3, E.3., and 4. In addition, the reviewing officials shall provide a written statement to the contracting officer, the contracting officer's supervisor, and the auditor on the propriety of the audit recommendation and the disposition accorded the recommendation by the contracting officer.

d. When the reviewing official or board identifies a need for additional or revised guidance, or changes in policy or regulatory requirements, details shall be forwarded to the appropriate office with suggestions for the change or additional guidance needed.

4. DoD Managers of Individual DoD Procurement or Contract Administration Offices shall:

a. Take prompt action to resolve all contract audit recommendations in accordance with acquisition guidelines and the requirements of this Directive.

b. Maintain and provide information required in conjunction with followup status reporting procedures.

c. Ensure the forwarding of required information to the designated review official or board responsible for reviewing the disposition of significant contract audit recommendations.

5. Heads of the Cognizant DoD Internal Audit Organizations shall:

a. Be responsible for internal reviews to determine if the DoD Components' follow-up systems on contract audit recommendations are adequate and result in timely and appropriate disposition of audit recommendations.

b. Complete the first evaluation of the system within 1 year of the system's implementation and perform evaluations every 2 years thereafter.

6. The Director of the Defense Contract Audit Agency shall:

a. Provide timely and complete support to any reviewing official or board's request for factual information or audit opinions regarding the audit recommendations under review.

b. Monitor all negotiation memoranda received. In cases where the negotiation memorandum indicates there is a substantial difference of opinion on the settlement of a significant audit recommendation, and the contracting officer did not request a review by the designated official or board, the DCAA shall request a review of the issue by the reviewing official or board. A record will be maintained of these instances and will be available to the ATSD(RO) and internal auditors upon request.

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c. Maintain in its management information system a record, including pertinent dollar amounts, of all instances reported by the contracting officer where the action taken has been different from that recommended by an independent acquisition official or review board.

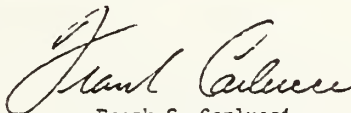
d. Provide timely and complete support to any internal audit organization reviewing a DoD Component's contract audit follow-up system.

F. INFORMATION REQUIREMENTS

Follow-up status reports (enclosure 2) for semiannual periods ending March 31 and September 30 shall be submitted to the OATSD(R&O) within 30 calendar days after the end of the period. The reporting requirements of this Directive have been assigned Report Control Symbol DD-R&O(SA) 1580. The status reports will provide an aged list of audit reports involving those items stipulated in subsection D.2. that have been open for more than 6 months, together with a projected target date for disposition. All listed items will be tracked until final disposition.

G. EFFECTIVE DATE AND IMPLEMENTATION

This Directive is effective immediately. Forward one copy of implementing documents to the Assistant to the Secretary of Defense (Review and Oversight) within 30 days. Follow-up systems shall be fully operational by September 30, 1981, and the first required semiannual report shall be prepared for the period ending March 31, 1982.



Frank C. Carlucci
Deputy Secretary of Defense

Enclosures - 2

1. Definitions
2. Follow-up Status Reports

Aug 31, 81
5000.42 (Encl 1)

DEFINITIONS

A. Contract Audit Recommendation. The contract auditor's written advice published in a formal contract audit report advocating specific action on the part of the contracting officer. This includes amounts questioned or disapproved, exceptions to a contractor's system, operations expressed in terms of cost avoidance, or a contractor's noncompliance with Cost Accounting Standards.

B. Significant Recommendation. (1) Any recommendation made on a negotiated contract action where the pricing proposal is at least \$500,000; (2) for audits other than those of pricing proposals, any report that has a potential financial effect of at least \$500,000 without regard to its impact on an individual contract; or (3) any recommendation involving improper practices regardless of dollar amount; or (4) any recommendation, regardless of dollar amount, which, in the judgment of officials, involves an issue that may have a significant impact on acquisition procedures or policy. Other thresholds may be used by DoD Components, on an exception basis, when justified in light of special circumstances and only with the written approval of the ATSD(R&O). Any recommendation having continuing impact at a particular contractor location, or that may affect other contractors, may be considered significant.

C. Disposition of Contract Audit Recommendation. Disposition is achieved when (1) the contractor implements the audit recommendation; (2) the contracting officer completes action after receiving and considering the report of the designated official, board, or panel; (3) the auditor agrees with the contracting officer or withdraws the audit recommendation; (4) a decision has been rendered on an appeal made to the Armed Services Board of Contracts Appeals or Court of Claims.

D. Contracting Officer. The procuring contracting officer, administrative contracting officer or termination contracting officer, as appropriate, when that individual is responsible for dealing with matters that are the subject of the audit report involved.

Aug 31, 81
5000.42 (Encl 2)

FOLLOW-UP STATUS REPORTS

A. GENERAL. Each acquisition and contract administration focal point shall prepare a semiannual status report in the format shown in attachment 1. The reports shall be submitted to the head of the DoD Component and to the Component's internal audit agency. Summary reports for the DoD Components shall be submitted to the OATSD(R&O). The reports will cover the semiannual periods ending March 31 and September 30 and shall be submitted within 30 calendar days after the end of the period. The first semiannual report will cover the period ended March 31, 1982.

B. PREPARATION

1. Each DoD Component shall establish procedures to account for and track all significant audit reports and recommendations, as described in subsection D.2., received by the DoD Component. A schedule, listing these audit reports shall be maintained by each DoD Component and shall serve as the source document for the semiannual follow-up status report. This record will track each audit recommendation until its disposition.

2. The follow-up status report will show all significant overaged contract audit reports. All identified contract audit reports will be considered overage 6 months after issuance of the contract audit report containing the significant recommendation. An estimated target date must be provided for resolution of the reports not completed by the end of the reporting period.

3. All items reported as open for more than 6 months will be tracked on this status report until final disposition is reported.

Attachment - 1
List of Overaged
Audit Recommendations

LIST OF OVERAGED CONTRACT AUDIT REPORTS

(continued)

FOR PERIOD ENDING

REPORTING

DoD COMPONENT

**Audit
Report
Number**

Audit Report Date	
-------------------------	--

| Contractor | Name |

Type of Contract Audit

	Total \$ Amount Audited
1. Balance forward	
2. Add: Cash on hand	
3. Add: Cash in bank	
4. Add: Cash in other banks	
5. Add: Cash in other currencies	
6. Add: Cash in other accounts	
7. Add: Cash in other funds	
8. Add: Cash in other investments	
9. Add: Cash in other assets	
10. Add: Cash in other liabilities	
11. Add: Cash in other equity	
12. Add: Cash in other income	
13. Add: Cash in other expenses	
14. Add: Cash in other transfers	
15. Add: Cash in other adjustments	
16. Add: Cash in other reconciling items	
17. Add: Cash in other corrections	
18. Add: Cash in other disclosures	
19. Add: Cash in other footnotes	
20. Add: Cash in other schedules	
21. Add: Cash in other exhibits	
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23. Add: Cash in other supplements	
24. Add: Cash in other addenda	
25. Add: Cash in other glosses	
26. Add: Cash in other indexes	
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29. Add: Cash in other charts	
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31. Add: Cash in other diagrams	
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143. Add: Cash in other updates	
144. Add: Cash in other revisions	
145. Add: Cash in other corrections	
146. Add: Cash in other disclosures	
147. Add: Cash in other footnotes	
148. Add: Cash in other schedules	

Total \$ Amount Questioned

	<u>Disposition Date</u>
	Original
	<u>Target Date</u>

Actual

Original	Target Data
1	1
2	2
3	3
4	4
5	5
6	6
7	7
8	8
9	9
10	10
11	11
12	12
13	13
14	14
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96	96
97	97
98	98
99	99
100	100

Current	Target
---------	--------

(YUEN)¹

(YYMMDD)¹

(YUFD)

(YHID),

Audit Reports
Reported as Open in
Prior Report

Audit Reports
Reported As Open in
Prior Report that were
Closed During the
Reporting Period

Overaged Reports
as of the Current
Reporting Period

1 (Year, Month, Day)

Aug 31, 81
5000.42 (Att 1 to Encl 2)

LIST OF REFERENCES

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5. Lamm, David V. An Examination of the Effect of the Contract Administration/Contract Audit Interface on the Authority and Effectiveness of the DoD Contracting Officer. Unpublished thesis, The George Washington University, Washington, D.C., February 1972.
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